

**Examination of Certain Policies, Procedures, Controls,
and Financial Activity of Dismas Charities, Inc.**



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April 5, 2011

Melinda K. King, Chair
Board of Directors
Dismas Charities, Inc.
2500 Seventh Street Road
Louisville, Kentucky 40208

LaDonna H. Thompson, Commissioner
Department of Corrections
275 East Main Street
Frankfort, Kentucky 40602

RE: Examination of Certain Policies, Procedures, Controls, and Financial Activity of Dismas Charities, Inc.

Dear Chairman King and Commissioner Thompson:

We have completed our examination of certain controls and management practices of Dismas Charities, Inc. and the associated contract oversight by the Kentucky Department of Corrections (Corrections). The report presents, in total, 10 findings and offers several recommendations to strengthen Dismas Charities' controls and management oversight procedures. Three of the findings and associated recommendations relate to Corrections' oversight of contracts with Dismas Charities.

Examination procedures included a meeting with Dismas Charities' Executive Staff, interaction with the Dismas Charities' attorney, and interviews with certain members of Corrections' management. We reviewed applicable Dismas Charities' and Corrections' policies and procedures, Corrections' contracts with Dismas Charities, as well as, limited expenditure documentation made available to this office. The scope of our examination encompasses documentation and records for the period July 1, 2008 through December 31, 2010, unless otherwise specified. The objectives developed by the Auditor of Public Accounts for this examination include:

- Review Dismas Charities operating policies and procedures to ascertain compliance with the APA's Recommendations for Public and Nonprofit Boards;
- Review contract oversight by the Department of Corrections;
- Determine whether the ultimate and specific expenditure of state funds provided to Dismas Charities by the Department of Corrections was reasonable and necessary, and identify excessive or unusual expenditures; and,

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- Report findings and recommendations related to these and other matters identified during the examination.

The purpose of this examination was not to provide an opinion on financial statements, but to ensure that processes are in place to provide strong oversight of financial activity through a review of Dismas Charities organization's policies, Board governance, certain internal controls, and other financial transactions. Nor was this examination intended to evaluate the quality of services provided to the Commonwealth by Dismas Charities, which is monitored by the Kentucky Department of Corrections. It is not the intent of this examination to report on Dismas Charities Foundation, Inc., which serves as the fundraising organization for Dismas Charities, or on Dismas Charities Properties, Inc., which purchases, leases, and/or otherwise acquires real property, and leases the property to Dismas Charities.

The Auditor of Public Accounts requests a report from Dismas Charities and the Department of Corrections on the implementation of audit recommendations within (60) days of the completion of the final report. If you wish to discuss this report further, please contact Brian Lykins, Executive Director of the Office of Technology and Special Audits, or me.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts



Examination of Certain Policies, Procedures, Controls, and Financial Activity of Dismas Charities, Inc.

Examination Objectives

On September 9, 2010, representatives of the Office of the Auditor of Public Accounts (APA) met with representatives from Dismas Charities, Inc. (Dismas Charities). During that meeting, it was agreed that the APA would conduct an examination into selected activities and transactions involving Dismas Charities. This examination was conducted in response to public reports and questions raised regarding certain financial transactions of Dismas Charities of which the APA became aware. The purpose of this examination was not to provide an opinion on financial statements, but to ensure that processes are in place to provide strong oversight of financial activity through a review of Dismas Charities organization's policies, certain internal controls, and other financial transactions. Nor was this examination intended to evaluate the quality of services provided to the Commonwealth by Dismas Charities, which is monitored by the Kentucky Department of Corrections.

The primary objectives developed by the APA for this examination include:

- Review Dismas Charities operating policies and procedures to ascertain compliance with the APA's Recommendations for Public and Nonprofit Boards;
- Review contract oversight by the Department of Corrections;
- Determine whether the ultimate and specific expenditure of state funds provided to Dismas Charities by the Department of Corrections was reasonable and necessary, and identify excessive or unusual expenditures; and,
- Report findings and recommendations related to these and other matters identified during the examination.

The scope of the examination encompasses only the records and information of Dismas Charities for the period July 1, 2008 through December 31, 2010, unless otherwise specified.

Limited Examination

The APA was unable to fully determine whether the ultimate and specific expenditure of state funds

provided to Dismas Charities by the Department of Corrections was reasonable and necessary, or the amount of excessive or unusual expenditures because Dismas Charities declined to provide certain financial information and documentation requested by the APA.

Dismas Charities Background

Dismas Charities, founded in 1964 and headquartered in Louisville, has a stated mission to provide quality, cost-effective, community-based supervision, treatment services, and programs to individuals within the criminal justice system and assist them in becoming positive, productive members of their communities. Dismas Charities, a not-for-profit, tax-exempt organization under Section 501(c)(3) of the United States Internal Revenue Code, administered by the Internal Revenue Service (IRS), has as its goal to prepare individuals to lead lawful and productive lives upon their return to the community.

Dismas Charities operates seven residential community corrections centers, or "halfway houses," within the Commonwealth of Kentucky, and 21 similar community correctional centers currently in 11 other states. The 28 centers house nearly 7,000 criminal offenders for a transition period prior to returning to their lives outside of a correctional institution. Since 1973, except for a period from 1977-1980, the Kentucky Department of Corrections has contracted with Dismas Charities to provide such transitional services at the Kentucky centers to persons being released to the community from prison.

The current Dismas Charities' By-laws provide for a Board of Directors consisting of 12 Directors who have the full power and authority to manage and control the affairs and business of Dismas Charities.

The Kentucky Department of Corrections contracts with Dismas Charities to provide fully operational halfway house beds at each of the Kentucky facilities based on the needs of the Department. Inmates housed by the Department of Corrections who meet certain criteria, for example no conviction of taking a life, and have 24 months or less time to serve or until parole review, are eligible to be housed at a halfway house.

Originally started with donations and volunteers, now the significant majority of dollars spent by Dismas Charities is derived from state and federal monies. Dismas Charities is funded primarily through public monies from the Commonwealth of Kentucky and the U. S. Bureau of Prisons. Receipt of state and federal resources requires accountability and transparency to the public of the use of those funds.

Review of Dismas Charities Policies and Procedures

The APA performed a comparison of certain Dismas Charities organizational policies, procedures, and other governing requirements to the APA's "Recommendations for Public and Nonprofit Boards" regarding financial oversight and internal control processes for board consideration. Through this comparison, we found that Dismas Charities policies, procedures, and practices overall provide an adequate framework of oversight and processes that govern the operations of the organization. We make recommendations in Chapter 3, Findings and Recommendations, to further strengthen certain controls and Board oversight procedures.

Review of the Department of Corrections' Oversight and Monitoring of its Contracts with Dismas Charities

The Kentucky Department of Corrections, the state agency responsible for the housing of criminal offenders, held two separate contracts with Dismas Charities during the period of examination. The first, a Master Agreement contract, was a single contract with Dismas Charities for the housing of inmates at its seven halfway houses throughout the Commonwealth. The Master Agreement is a firm fixed unit price contract, referred to by the Department of Corrections as a "no-bid" contract, whereby the Department of Corrections established "per diem" rates that it would pay for halfway house services, regardless of the provider of services. Any transitional care provider may enter into a contract with the Department of Corrections to provide such services.

The second contract, a Personal Service Contract, was a contract with Dismas for substance abuse treatment services. The contract, which was effective during the period of examination until June 30, 2010, was to provide an Extended Intensive Substance Abuse Treatment Program in Louisville as an alternative to incarceration.

To ensure compliance with the Master Agreement and Personal Service Contract requirements and payment procedures, the APA reviewed the Department of Corrections' oversight and monitoring of Dismas

Charities. The Department of Corrections' procedures for ensuring compliance with the Master Agreement contract, which provided halfway house services, included both detailed inspections at the halfway house facilities and a thorough process for ensuring the accuracy of and support for payments made to Dismas Charities under the Master Agreement. Even so, the inspections conducted did not appear to be broad enough to ensure that all of the requirements specified in the Master Agreement were reviewed for compliance. See Finding 9 for recommendations regarding this matter.

The Department of Corrections' control procedures for ensuring proper payment of invoices under the Personal Service Contract, which provided an "extended intensive outpatient substance abuse treatment program," included a comprehensive verification process to confirm that the invoices were accurate and had supporting documentation.

Review of Dismas Charities' Expenditures

The APA made a conscientious attempt to determine whether the ultimate and specific use of state funds paid to Dismas Charities by the Department of Corrections was in keeping with its mission, was a reasonable and necessary expenditure of public funds, or was excessive or unusual. The APA was restricted by Dismas Charities to reviewing only a limited area of expenditures, primarily the travel reimbursements made to employees at Kentucky facilities. Expenditures incurred at Dismas Charities' corporate office could not be examined because Dismas Charities declined to provide other financial information and documentation as requested by the APA. Also requested, but not provided, was any information as to the income or source of funds used for expenditures at corporate headquarters.

Furthermore, after an initial overview meeting between an APA auditor and Dismas Charities Executive Staff, Dismas Charities took a position of not allowing the APA to have any individual contact with Dismas staff during the conduct of the examination, other than with or through its outside attorney. The majority of the many questions that the APA had during the course of the examination were never sufficiently answered, limiting our ability to conduct a full review.

Without the information requested, the APA was unable to determine how state monies paid to Dismas were ultimately used, and whether such expenditures were a reasonable and appropriate use of public funds in keeping with the mission of Dismas Charities. Findings as a result of the above detailed procedures are documented in Chapter 3, Findings and Recommendations, of this report.

Findings and Recommendations

Finding 1: Dismas Charities Board of Directors' lack of review and approval weakens control and oversight necessary for accountability.

During the examination of Dismas Charities, no evidence was found of any review or approval by Dismas Charities' Board of Directors of policy manual adoptions or changes, contract agreements for goods and/or services, Executive Staff travel expenditures, or certain financial matters, including budget to actual expenditures. Dismas Charities is responsible for ensuring that the public monies it receives for services provided are used in a responsible manner that serves the interests of both the recipients of the Dismas' services as well as the taxpayers who ultimately fund the service. The lack of involvement by the Board in such matters indicates that the oversight and control over the responsible use and safeguarding of public funds expended by Dismas Charities is weakened.

Recommendations:

We recommend that Board of Directors strengthen its policies to provide guidance and oversight for the operational aspects of Dismas Charities, including oversight of financial matters. We recommend that the Board review any adoption of, or changes to, Dismas Charities' policy and procedure manuals prior to implementation. Such review and approval should be noted in the Board meeting minutes. Changes to manuals should be reviewed and approved by the Board before new manuals are distributed to employees. We recommend the Board establish policies that require a formal contract, and Board review and approval, for purchases over a specified aggregate dollar amount. We also recommend the Board be apprised of all contracts implemented in an "emergency" situation. We recommend when bidding is required, and the lowest bid is not accepted, or an "emergency" contract is approved, the Board be notified of the reasoning behind the decisions and the justification to be presented to the Board for review. We recommend the Board, or a designated committee of the Board, pre-approve Executive Staff out-of-state travel, and estimated costs, including prior approval of chartered planes and first class airfare. The Board meeting minutes should document the review conducted by the Board. We also recommend the Board require a report of the actual travel expenses of Executive Staff, with Board approval, prior to expense reimbursement. The expense reports should sufficiently detail the expenses associated with meals, lodging, transportation, and entertainment of each trip, as well as the business purpose of each expense item. We recommend that the Board, or a designated committee of the Board, perform a regular review of budget to actual expenditures to monitor costs in each account. The name and number of budget categories should provide transparency and sufficient detail to allow Board members to accurately

identify the types of expenses attributed to each category. At least quarterly, the Board or a designated committee of the Board, should receive and review a listing of expenditures with sufficient detail to identify inappropriate, unusual or excessive expenditures. The Board meeting minutes should document the exact nature and extent of the financial reviews conducted by the Board. Any issues that result from these reviews and any action taken to resolve the issues also should be documented.

Finding 2: Several of Dismas Charities' policies need strengthening to achieve greater accountability.

Dismas Charities has in place a comprehensive set of policies and procedures implemented to provide adequate internal controls and proper oversight and accountability of its organization. Nevertheless, in order to provide the accountability that is required for a nonprofit organization that receives a significant majority of its funds to operate from public sources, certain of the policies within these documents need to be strengthened.

Recommendations: We recommend all policies within Dismas Charities' Policy Manual, Employee Handbook, Human Resources Policies and Procedures Manual, and Fiscal Procedures Manual be consistent. All policies of which employees need to be aware for proper organizational control, oversight, and transparency should be included in the Employee Handbook and Human Resources Policies and Procedures Manual, both of which are available to all employees. We recommend that a credit card usage and oversight policy be included in Dismas Charities' Policy Manual, Employee Handbook, Human Resources Policies and Procedures Manual, and Fiscal Procedures Manual detailing required supporting documentation, timely review by the Board or committee, and approval of Executive Staff credit card statements. We recommend the travel reimbursement policies included in the Fiscal Procedures Manual also be detailed in the written policies provided to employees, such as in the Employee Handbook and Human Resources Manual, so that employees will be informed of the proper procedures to follow when submitting requests for reimbursement of expenses. We further recommend that the reimbursement policy provide specific, consistent timeframes for employees to submit their requests for reimbursement of expenses. Any forms required to be used for the reimbursement process should be readily available to all employees. Dismas management should ascertain that proper approval of employee expense reports is given prior to any reimbursements made. We also recommend policies be implemented to ensure that the Board of Directors or a designated committee review and approve all executive management reimbursements and

supporting documentation to ensure the reimbursements are for reasonable and necessary expenditures. Such reviews and approvals also will help ensure that duplicate payments are not made. We recommend that Dismas Charities further strengthen its equipment and vehicle usage policies by establishing policies that include an authorization process to purchase vehicles and method of disposal. The use and assignment of vehicles should be addressed within these policies. We recommend policies stipulate when personal use of vehicles or equipment is acceptable. If Dismas Charities intends to prohibit the personal use of company vehicles, it should be clearly stated in the policy. If personal usage is allowed, then the policy should include acceptable permissive use of a vehicle. Dismas Charities has limited policies in the area of personal use of business equipment, and might want to consider expanding this area to provide more definitive guidance such as: who should approve, sign out of equipment, time limitations, etc. The policies also should include following IRS guidelines pertaining to use of a vehicle by an employee. We recommend Dismas Charities expand its property and inventory control policies to incorporate an annual, or periodic, physical inventory of all fixed assets. We also recommend Dismas Charities develop a process to be followed by an employee when equipment is found to be missing, damaged, or inappropriately used. The property inventory and control policy should be made available to employees who have responsibility for property assets and should include sufficient procedural detail to insure accurate and appropriate accounting for property inventory. Dismas may want to accomplish this recommendation by including its inventory and property control policies in its Employee Handbook.

Finding 3: Dismas Charities spent funds on sporting and entertainment events with questionable benefit to its mission.

Dismas Charities expended significant funds for Dismas sponsored activities that had questionable benefit or that were not aligned with its stated mission. Specific questionable activities included leasing a suite at the KFC Yum! Center and at Papa John's Cardinal Stadium, renting a hospitality "caboose" for the University of Louisville football games, financially sponsoring Bellarmine University's basketball team, and hosting various social events including an annual Derby Gala, an annual Holiday Open House, and golf outings. Thus, questions arise as to whether the benefit received by Dismas Charities' from such affiliations with the universities was comparable to the funds expended, and also whether the expenditures for the Galas, open houses, and golf outings were fundraisers or simply extravagant social events.

Recommendations: A not-for-profit organization such as Dismas Charities that primarily receives public

funds, and has a privileged tax status, has an obligation to the general public to spend such funds in a fiscally responsible manner. We recommend all expenditures made by a not-for-profit organization be an appropriate use of public funds and be tied to the ultimate mission of the organization, which in the case of Dismas Charities is to provide transitional care for inmates in order to prepare them for life outside of a correctional institution. We recommend Dismas Charities' Board of Directors develop policies that provide specific guidance for staff members on the proper use of Dismas Charities' financial resources that support Dismas Charities' mission. The Board should demonstrate a strong board commitment for the responsible and effective use of its funds. Procedures should be in place to review and monitor expenditures to ensure they are reasonable and necessary for Dismas Charities to carry out its mission. We recommend the Board emphasize to staff the importance of the proper use of publicly generated funds and ensure such funds are used in the best interest of the clients served. As previously recommended, at least quarterly, the Board should perform a review of budgeted to actual expenditures for the corporate office, as well as for each individual facility, to monitor expenditures within each account. Budget categories should provide sufficient transparency and detail so that Board members can identify the types of expenses, such as sporting and entertainment events, attributed to each category, and whether such expenses are inappropriate, unusual, or excessive. We further recommend that Dismas Charities' Board have clearly stated policies and procedures concerning fundraising. These policies and procedures should be supported and enforced by Board members and clearly communicated to staff.

Finding 4: Dismas Charities' Executive Staff received significant compensation through salaries, bonuses, and other provided benefits.

With the results of a compensation salary study finding Dismas Charities' top two executives at the top of the national range for all non-profit organizations, and ranked above the 90th percentile for transition care industries, such salaries are significant in relation to the mission and purpose of the organization. Further, although the Personnel Committee approved the President/CEO's incentive bonus, Dismas Charities did not appear to have policies requiring the Board to review and approve the President/CEO's compensation on an annual basis.

Recommendations: We recommend Dismas Charities Board of Directors adopt a policy to review and approve the salary and bonus incentives of the Executive Staff on an annual basis to ensure that the compensation paid is equitable to the responsibilities and duties of each position. The salaries should be reviewed specifically by the Board to ascertain

appropriate use of public funds given the mission of Dismas Charities. Salaries should be fair and equitable for all staff members. We recommend the Board of Directors have involvement in the overall budget process for Dismas Charities, including approving the use of any “net savings.” Any excess funds derived from efficiencies and incentive goals should be allocated to areas that support the appropriate use of public funds and the ultimate purpose of Dismas Charities to provide transitional services to assist persons released to the community from a correctional institutional.

Finding 5: Dismas Charities ethical policies for Board members, officers, and employees do not cover all areas of standards.

Although Dismas Charities By-laws, Human Resources Policies and Procedures Manual, and Employee Handbook contain many sound ethical policies, the policies do not address solicitation of vendors or employee use of Dismas Charities’ property and equipment. Further, policies for investigating unethical activity and criteria for sanctions or disciplinary procedures are not detailed.

Recommendations: Although we believe the standards of conduct for Board members, officers, and employees are relatively strong as written in Dismas Charities’ Human Resources Manual and Employee Handbook, we recommend Dismas Charities strengthen its policies to include provisions addressing the following: Solicitation of Vendors and Personal Use of Dismas Charities Property/Equipment. Such policies should include that any Board members and employees involved in the solicitation or acceptance of donations from vendors should have no responsibilities in the selection and oversight of Dismas Charities vendors. In order to ensure compliance with Dismas Charities’ code of conduct and ethical policies, we recommend Dismas adopt policies, procedures and responsibilities for investigating reported ethical misconduct and criteria for sanctions or disciplinary procedures.

Finding 6: Dismas Charities’ whistleblower policy does not provide an avenue for employee concerns to be brought directly to the Board.

Although Dismas Charities has a written whistleblower policy in both its Human Resources and Procedures Manual and its Employee Handbook, neither version includes procedures that provide a method for employees and/or volunteers at any level, to bring their concerns directly to the Board. Further, Dismas Charities has no internal audit function that investigates and examines issues assigned by the Board of Directors and that reports directly to the Board.

Recommendations: We recommend Dismas Charities strengthen its whistleblower reporting policies by creating and documenting an independent process

whereby employees and/or volunteers have the option to directly make the Board aware of concerns involving matters that specifically need Board oversight. We recommend the Board establish methods that allow for concerns to be reported directly to their attention by all staff, including anonymous concerns, and any complaints against Executive Staff. Such methods could include the use of the current hotline, but with an option that allows the complainant to request the matter be reported directly the Board. We recommend the Board further develop a process by which concerns are brought to the attention of the Board and ensure a process exists to analyze, investigate and resolve issues brought to its attention. An internal audit function could be used to ensure that concerns brought to the Board are independently investigated. The internal auditor should report findings directly to the Board.

Finding 7: Dismas Charities’ Board members received no formal orientation regarding their legal and fiduciary responsibilities.

During the examination, auditors were unable to locate any documentation stating that an orientation for Board members is required or provided. The Board By-laws and meeting minutes do not reference a required orientation process when new members are sworn in. Dismas Charities’ Executive Staff indicated that there is an annual orientation program consisting of written materials, facility tour with question and answer sessions, and informal information for new and returning Board members. However, no documentation of such a program or manual was provided or evidenced during the examination.

Recommendations: We recommend the Board provide annual orientation training for new and returning Board members to ensure the members have at a minimum, a clear understanding of the Dismas Charities’ organizational structure and policies, their responsibilities as Board members, as well as their legal and fiduciary roles, and the purpose of the board on which they serve. In addition, the orientation should address ethical requirements of Board members and staff and any significant policy changes adopted by Dismas Charities during the previous year. Material for the orientation should be written and formally presented in a manual to facilitate the orientation process and serve as a useful reference tool for Board members. The orientation manual should provide a description of Dismas Charities structure, its revenue and investment information, as well as all ethics policies for Board members and staff of Dismas Charities. We also recommend that the orientation be facilitated by a knowledgeable independent party, such as a Board attorney who can participate in and oversee the orientation training. We further recommend that upon completion of orientation Board members sign a statement attesting that they have attended the

orientation and received and read the orientation manual. Dismas Charities should retain the signed statements as documentation of the Board members' attendance.

Finding 8: The Department of Corrections' Master Agreement with Dismas Charities does not contain standard contract language authorizing the APA access to the contractor's records.

The majority of funds paid by the Department of Corrections to Dismas Charities were paid through a Master Agreement contract for halfway house services; however, that contract did not contain standard state required language that authorizes the APA or other Kentucky state agencies to access the contractor's records. This includes access to accounting records, documents, and other evidence. A separate Department of Corrections contract with Dismas Charities for a substance abuse treatment program, however, did allow such access to certain Dismas records. It is unclear why language authorizing the APA and other state agencies access to records pertinent to a contract where the Department of Corrections spent less than \$300,000 annually, would also not be included in a contract where the Department spent over \$7 million per year.

Recommendations: We recommend that all contracts between the Department of Corrections and Dismas Charities, including no-bid contracts, provide language to allow the APA and other appropriate state agencies access to all pertinent contractor's records including, but not limited to, accounting records, documents, papers, records, or other evidence. Further, we recommend contract language comply with KRS 45A.030(7) to ensure "[t]he Secretary of the Finance and Administration Cabinet shall not restrict the public release of any information which would otherwise be subject to public release if a state government agency was providing the services." Finally, we recommend that the Department of Corrections work with the Finance and Administration Cabinet to revise the Master Agreement with Dismas Charities to include the standard contract language from KRS 45A.030(7).

Finding 9: Certain contract requirements were not reviewed for compliance.

The Department of Corrections did not review certain contract requirements for compliance with the Master Agreement contract between the Department of Corrections and Dismas Charities. To assure the Department of Corrections that Dismas Charities complied with the requirements of the Master Agreement between Corrections and Dismas, Corrections conducted a minimum of two inspections per year at each of the seven Dismas Charities' halfway house facilities. Yet, the inspections conducted did not appear to be broad enough to ensure that all of the

requirements specified in the contract were reviewed for compliance.

Recommendations: We recommend the Department of Corrections expand its monitoring and oversight of its Master Agreement with Dismas Charities for halfway house services to ensure that all significant contractual obligations relating to halfway houses are reviewed through its inspection process. The inspection form used in this process should include a checklist item for each area deemed subject to compliance oversight and should be periodically updated to include all significant areas of compliance.

Finding 10: A cost analysis was not performed by the Department of Corrections to determine the cost effectiveness of Dismas Charities.

The Department of Corrections did not complete an evaluation of the cost the Commonwealth would incur to operate halfway house facilities in lieu of using those operated by Dismas Charities or other similar vendors. Without a cost analysis, the Department of Corrections cannot clearly determine fair per diem rates that should be paid to vendors to house offenders at halfway house facilities.

Recommendations: We recommend the Department of Corrections conduct a periodic analysis, to compare the per diem rates paid to Dismas Charities for halfway house services to the costs that would have been incurred by the Commonwealth if the same services had been provided by the Department of Corrections internally. Such an analysis should project and identify any actual savings for the Commonwealth through the use of outside vendors such as Dismas Charities for halfway house services. The Department of Corrections should use the results of this analysis also to determine whether its per diem rates need any adjustment in order to provide necessary and adequate community based supervision and treatment services to those within the prison system, as well as to determine that the Department is paying an appropriate amount for the services. Documentation of the analysis to support the per diem rates should be retained.

Chapter 1

Introduction and Background

Scope

On September 9, 2010, representatives of the Office of the Auditor of Public Accounts (APA) met with representatives from Dismas Charities, Inc. (Dismas Charities). During that meeting, it was agreed that the APA would conduct an examination into selected activities and transactions involving Dismas Charities. Procedures for this examination began on November 1, 2010. This examination was conducted in response to public reports and questions raised regarding certain financial transactions of Dismas Charities of which the APA became aware. The purpose of this examination was not to provide an opinion on financial statements, but to ensure that processes are in place to provide strong oversight of financial activity through a review of Dismas Charities organization's policies, Board governance, certain internal controls, and other financial transactions. Nor was this examination intended to evaluate the quality of services provided to the Commonwealth by Dismas Charities, which is monitored by the Kentucky Department of Corrections.

The scope of the examination encompasses only the records and information of Dismas Charities for the period July 1, 2008 through December 31, 2010, unless otherwise specified. It is not the intent of this examination to report on Dismas Charities Foundation, Inc., which serves as the fundraising organization for Dismas Charities, or on Dismas Charities Properties, Inc., which purchases, leases, and/or otherwise acquires real property, and leases the property to Dismas Charities.

The Certification section of the Personal Service Contract that expired on June 30, 2010, between the Kentucky Department of Corrections and Dismas Charities for substance abuse treatment authorized the APA to have access to information of Dismas Charities, in order to conduct a financial audit or a program review of matters pertinent to the contract.

Goals and Objectives

Dismas Charities is funded primarily through state and federal sources including funds from the Commonwealth of Kentucky as well as the Federal (U.S.) Bureau of Prisons. Approximately 22 percent of its funding is derived directly from the Commonwealth and 75 percent from the U.S. Bureau of Prisons, totaling 97 percent from public funds. See Table 1. The APA has the responsibility to assure the taxpayers of the Commonwealth that public funds are used properly in compliance with contract requirements and their intended purpose, and that the ultimate use of public funds is transparent to the public.

The primary objectives developed by the APA for this examination include:

- Review Dismas Charities operating policies and procedures to ascertain compliance with the APA's Recommendations for Public and Nonprofit Boards;
- Review contract oversight by the Department of Corrections;
- Determine whether the ultimate and specific expenditure of state funds provided to Dismas Charities by the Department of Corrections was reasonable and necessary, and identify excessive or unusual expenditures; and,

Chapter 1

Introduction and Background

- Report findings and recommendations related to these and other matters identified during the examination.

Limited Examination

The APA was unable to fully determine whether the ultimate and specific expenditure of state funds provided to Dismas Charities by the Department of Corrections was reasonable and necessary, or the amount of excessive or unusual expenditures because Dismas Charities declined to provide certain financial information and documentation requested by the APA.

Although some limited expenditure documentation was provided to the APA, the APA was unable to ascertain that the expenditures reviewed included all expenses given that Dismas Charities declined to provide the APA access to financial statements that were needed to substantiate totals.

Further, although requested by the APA, Dismas did not provide expenditure listings, documentation or financial statements of Dismas Charities' corporate headquarters. Thus, the auditors were unable to review any expenditures made from corporate headquarters. Also requested, but not provided, was any information as to the income or source of funds used for expenditures at corporate headquarters.

Without the information requested, we were unable to determine how state monies paid to Dismas were ultimately used, and whether such expenditures were reasonable and in keeping with the mission of Dismas Charities.

Dismas Charities Background

Dismas Charities, founded in 1964 and headquartered in Louisville, has a stated mission to provide quality, cost-effective, community-based supervision, treatment services, and programs to individuals within the criminal justice system and assist them in becoming positive, productive members of their community. Dismas Charities, a not-for-profit, tax-exempt organization under Section 501(c)(3) of the United States Internal Revenue Code, which is administered by the Internal Revenue Service (IRS), has as its goal to prepare individuals to lead lawful and productive lives upon their return to the community.

Dismas Charities operates seven residential community corrections centers, or "halfway houses," within the Commonwealth of Kentucky, and 21 similar community correctional centers currently in 11 other states. The 28 centers house nearly 7,000 criminal offenders for a transition period prior to returning to their lives outside of a correctional institution. Since 1973, except for a period from 1977-1980, the Kentucky Department of Corrections has contracted with Dismas Charities to provide such transitional services at the Kentucky centers to persons being released to the community from prison.

According to Dismas Charities' Articles of Incorporation, its purpose is to establish, maintain, and operate facilities and programs that provide services and sanctions for the offender and the community consistent with its mission.

**Board
Administration**

The current Dismas Charities' By-laws provide for a Board of Directors consisting of 12 Directors who have the full power and authority to manage and control the affairs and business of Dismas Charities. Board members serve three year terms with one-third of the Directors (four) rotating off the Board each year, unless they are reappointed. The Board holds an Annual Meeting, as well as monthly, and special called meetings. No later than 45 days before the date of each Annual Meeting, applications are submitted to the Personnel Committee for persons to fill the four upcoming vacancies on the Board. Nominations, including the resume of the person nominated, must be in writing and delivered to the attention of the Chairman of the Personnel Committee. After the date for submitting nominations has passed, the Personnel Committee reviews and evaluates the qualifications of each candidate and submits to the full Board its list of recommended candidates. At the Annual Meeting, the Board elects the four new (or reappointed) Directors.

The officers of the Board consist of Chairman, Vice Chairman, Secretary, and Treasurer. All officers of the Board are elected at the Annual Meeting and serve for a term of one year and until their successors are elected and qualified. An officer may be removed from office by a two-thirds majority vote of the Board. Standing committees and responsibilities include:

- Executive Committee – Supervise and implement the Board's policies between regular board meetings;
- Personnel Committee – Interview, evaluate, and make recommendations to the Board with respect to: 1) nominations for membership to the Board, 2) alleged grievances against Board members, and 3) other matters involving the President and other officers of the Corporation; and,
- Finance Committee – Prepare and present the annual budget to the Board.

Other committees also may be established by the Chairman of the Board, subject to approval by the Board.

Corporate Officers

Corporate officers established by the By-laws include a President/Chief Executive Officer (CEO) to be employed by the Board. The President/CEO may employ one or more Vice Presidents, a Chief Financial Officer (CFO), a Secretary, and such other officers as the President/CEO may deem advisable.

President - The President is the Chief Executive Officer of the Corporation and supervises and controls all of the businesses and affairs of Dismas Charities. The President performs all duties pertinent to the office of President and such other duties as may be prescribed by the Board from time-to-time, including, but not limited to, taking all reasonable steps to ensure that Dismas Charities is in compliance with all applicable laws and regulations, implementing the Board's policies, implementing organized management and administrative functions, and influencing the establishment of clear lines of responsibility and accountability within and between Dismas' departments.

Vice Presidents – Each Vice-President performs duties as from time-to-time are assigned by the President/CEO.

Secretary – The Secretary is the custodian of the corporate records and may sign, along with the President/CEO, any deeds, mortgages, bonds, contracts or other instruments that the Board has authorized to be executed, except in cases where the Board is expressly required by law to sign. The Secretary performs all duties pertaining to the office of Secretary and such other duties as from time-to-time may be assigned by the President/CEO.

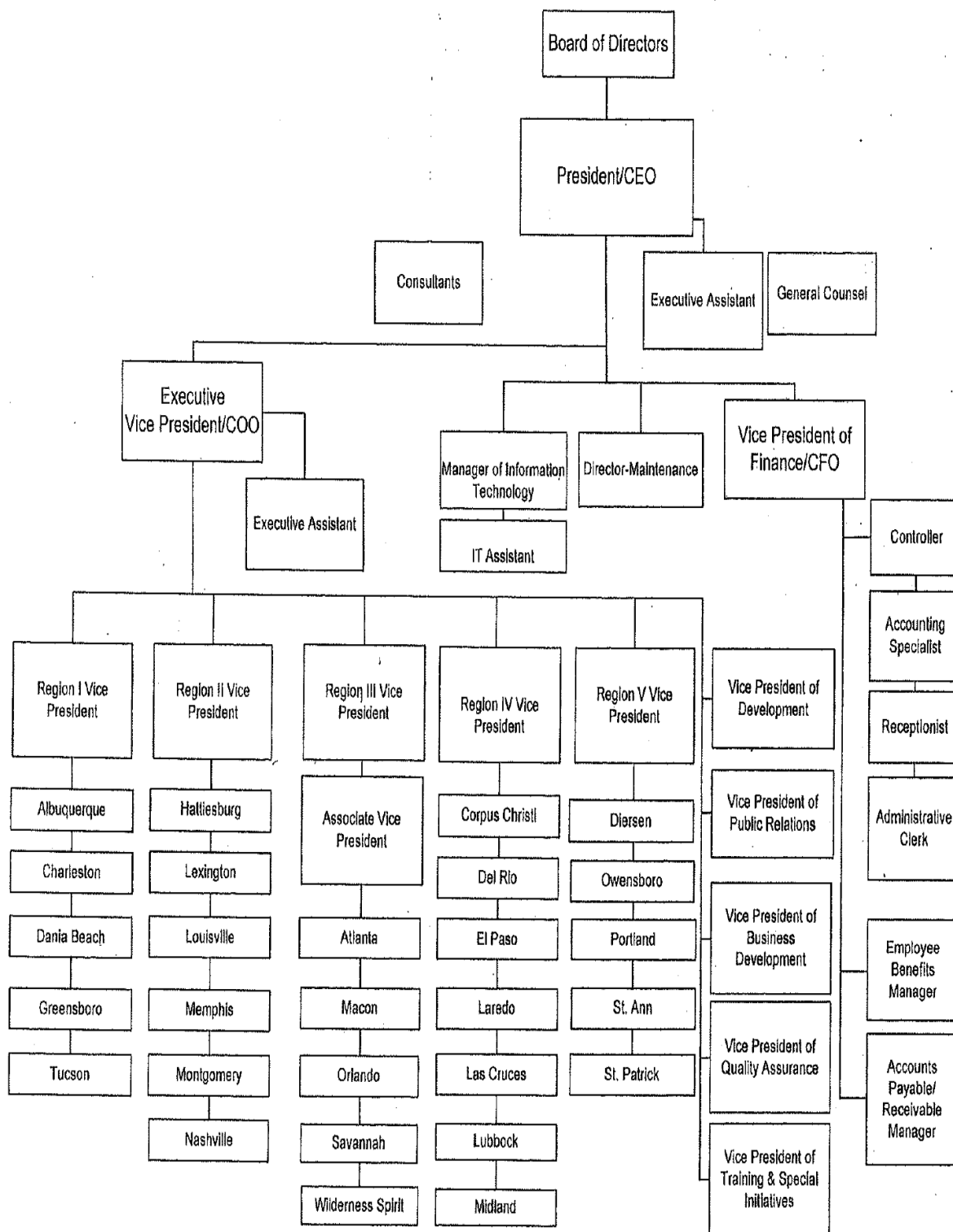
Chief Financial Officer – The CFO has charge and custody of and is responsible for all funds and securities of Dismas Charities, among other responsibilities. The CFO makes reports as necessary to the Board and to all standing committees of the Board. The CFO performs all duties pertaining to the office of Treasurer and such other duties as from time-to-time may be assigned by the President/CEO.

The following chart illustrates the organizational structure of Dismas Charities, Inc.

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Dismas Charities, Inc. Organizational Chart



Source: Dismas Charities, Inc.

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Services

In conjunction with its mission to provide quality, cost-effective community based re-entry services to individuals within the criminal justice system and assist them in becoming positive, productive members of their community, Dismas Charities operates 28 “halfway house” facilities in Kentucky, Georgia, Florida, Texas, New Mexico, Tennessee, North Carolina, Mississippi, Arizona, Alabama and West Virginia. To inform and involve communities, each facility hosts a Community Advisory Board composed of citizens and community advocates. Every facility is staffed 24 hours a day, 365 days a year.

In Kentucky, Dismas Charities operates seven community residential correctional centers, or halfway houses, as listed below:

Portland (Louisville)
Louisville
Owensboro
Lexington
St. Ann’s (Louisville)
St. Patrick’s (Louisville)
Diersen Center (Louisville)

The Kentucky Department of Corrections contracts with Dismas Charities to provide fully operational halfway house beds at each of the above facilities based on the needs of the Department. Inmates housed by the Department of Corrections who meet certain criteria, for example no conviction of taking a life, and have 24 months or less time to serve or until parole review, are eligible to be housed at a halfway house.

Each facility, or center, within the Commonwealth is required, per the most recent contract, to provide and maintain various services and written policies, including but not limited to:

- Information systems and records on each resident;
- Twenty-four hour awake supervision;
- Areas for sleeping, counseling, group meetings, indoor recreation, visiting, dining and lounge space;
- Laundry facilities;
- Daily logs for all significant occurrences within the center;
- Safety and emergency procedures;
- Sanitation and hygiene;
- Medical services;
- Food services;
- Counseling services;
- Religious programs;
- Recreations programs;
- Community service work programs;

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- Academic and vocational education;
- Mental health services;
- Inmate rights;
- Grievance procedures; and,
- Disciplinary procedures.

The Department of Corrections, during our examination period beginning July 1, 2008, also contracted with Dismas Charities through June 30, 2010, to provide an Extended Intensive Outpatient Substance Abuse Treatment Program.

Funding

Dismas Charities is funded primarily through public monies from the Commonwealth of Kentucky and the U. S. Bureau of Prisons. See Table 1 detailing the public source of funds reported by Dismas Charities on its 2009 Internal Revenue Service (IRS) Form 990.

Table 1: Public Support v. Total Support

Revenue Type	2008	Percent	2009	Percent	Total	Percent
Public Gifts, Grants, Contributions and Membership Fees Received*	\$35,058,273	95.8%	\$38,124,067	97.9%	\$73,182,340	96.9%
Interest, Dividends, Rents, Royalties, Etc.	\$1,155,064	3.2%	\$467,740	1.2%	\$1,622,804	2.2%
Other Income	\$383,303	1.0%	\$332,847	0.9%	\$716,150	0.9%
Total	\$36,596,640	100%	\$38,924,654	100%	\$75,521,294	100%
Public Support Percentage	95.8%		97.9%		96.9%	

Source: Dismas Charities 2008 and 2009 IRS Form 990s

*Includes Funds Received from State and Federal Governments Under Contracts

The consolidated financial statements for Dismas Charities, Dismas Charities Foundation, Inc., and Dismas Properties, Inc., provides a breakdown between state and federal revenue in Table 2, with the state revenue coming entirely from the Commonwealth of Kentucky.

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Table 2: Dismas Charities Source of Revenue and Support

Support and Revenue:	2008	Percent	2009	Percent
Service Contracts:	Revenue		Revenue	
Federal	\$ 23,810,385	66.1%	\$ 27,376,067	70.4%
State (Commonwealth of Kentucky)	7,993,424	22.2%	7,964,813	20.5%
Resident Subsistence:				
Federal	2,858,240	7.9%	2,539,050	6.5%
State (Commonwealth of Kentucky)	148,182	0.4%	110,231	0.3%
Contributions	40,674	0.1%	15,024	<0.1%
Other Revenue	<u>515,521</u>	<u>1.4%</u>	<u>549,147</u>	<u>1.4%</u>
Total Revenue	\$ 35,366,426	98.1%	\$ 38,554,332	99.2%
Other Support:				
Interest and Dividends	\$ 672,049	1.9%	\$ 309,863	0.8%
Gain on Property Sale	<u>3,150</u>	<u><0.1%</u>	<u>14,407</u>	<u><0.1%</u>
Total Revenue and Other Support	\$ 36,041,625	100%	\$ 38,878,602	100%

Source: Dismas Charities Audited Financial Statements, Consolidated Statement of Activities (Includes Dismas Foundation, Inc., and Dismas Properties, Inc.)

Dismas Charities was established for the purpose of returning criminal offenders back to society with the necessary survival skills and support structure needed for their release from prison. Originally started with donations and volunteers, now the significant majority of dollars spent by Dismas Charities is derived from state and federal monies. Receipt of state and federal resources requires accountability and transparency to the public of the use of those funds.

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Audit Procedures and Results

Introduction to Chapter 2

The major objectives developed by the APA for this examination include:

- Review Dismas Charities operating policies and procedures to determine compliance with the APA's Recommendations for Public and Nonprofit Boards;
- Review contract oversight by the Department of Corrections;
- Determine whether the ultimate and specific use of state funds provided to Dismas Charities by the Department of Corrections was reasonable and necessary, and identify any excessive or unusual expenditures; and,
- Report findings and recommendations related to these and other matters identified during the examination.

Audit procedures were developed for each of the first three objectives with the goal of a comprehensive analysis to be completed. The procedures and results of the first three objectives listed above are detailed below.

Review of Dismas Charities Policies and Procedures

The APA performed a comparison of certain Dismas Charities organizational policies, procedures, and other governing requirements to the APA's "Recommendations for Public and Nonprofit Boards" regarding financial oversight and internal control processes for board consideration. These APA recommendations originally were released on May 11, 2009, and were revised further on March 4, 2010, following examinations of certain non-profit organizations.

When performing this comparison, the APA reviewed various documents and manuals provided by Dismas Charities including, but not limited to the following:

- Board meeting minutes;
- Committee meeting minutes;
- IRS Form 990s;
- Articles of Incorporation;
- By-laws;
- Organizational Chart;
- Fiscal Procedures Manual;
- Policy Manual;
- Employee Handbook;
- Human Resources Policies and Procedures Manual;
- Compensation Review;
- Executive Bonus Plan;
- Kentucky Facility Travel Expenses;
- Employee Evaluations;
- Conflict of Interest Certifications; and,
- Various other information provided by Dismas Charities.

Through this comparison, we found that Dismas Charities policies, procedures, and practices overall provide an adequate framework of oversight and processes that govern the operations of the organization. We make recommendations in Chapter 3, Findings and Recommendations, to further strengthen certain controls and Board oversight procedures.

The following provides a listing of the APA's 32 "Recommendations for Public and Nonprofit Boards" with any findings as a result of the comparison to Dismas Charities policies, procedures, and practices, referenced to Findings and Recommendations in Chapter 3.

1. The Board should have a well defined, clear mission statement to serve as a platform for policies, operational plans, and resource allocations that further the interest of its organization's members. **Dismas Charities appears to have adequately complied with this recommendation.**
2. The Board should facilitate the development of an annual orientation program and manual for new and returning Board members to ensure an understanding of the Board's structure, operations, and their legal and fiduciary responsibilities. An explanation of the budget and accounting structure, as well as revenue and investment information should also be included. If possible, the orientation should be facilitated by a knowledgeable, independent party, such as a Board attorney or consultant. **See Finding 7.**
3. The Board should ensure that its organizational structure maintains a flexibility that allows for multiple sources of information. The Board should request reports from individuals having responsibility for various program areas rather than from just the chief executive. **Dismas Charities appears to have adequately complied with this recommendation.**
4. The Board meeting minutes should document the exact nature of the financial reviews conducted by the Board. Any issues that result from these reviews and action taken to resolve the issues should also be documented. **See Finding 1.**
5. For Boards which fall under the open meetings law, sessions closed to the public should be entered into in accordance with KRS 61.810. Any conclusions or decisions reached during a session closed to the public must be documented in the Board meeting minutes as stated in KRS 61.815, clarified in OAG 81-387. **KRS 61.810 is not applicable.**

6. The Board should establish an independent process to receive, analyze, investigate, and resolve concerns related to the organization including anonymous concerns. Employees, business associates, customers, or the general public may have significant, beneficial information that they are uncomfortable reporting directly to the Board. A toll-free complaint number or an advertised email and postal address for feedback would allow the transmission of this information. In addition, where applicable, the Board's policy should include a reference to Kentucky law (KRS 61.102) notifying employees, as defined in KRS 61.101, of their rights to protection against retaliation for reporting violations to certain authorities. A whistleblower policy should be adopted and distributed to employees. The policy should include reporting procedures and management's responsibility to address issues reported. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 6.**

7. An internal audit function could be used to ensure that Board concerns are independently investigated. The individual designated to perform internal audits should be given the authority to investigate and examine any area designated by the Board and the responsibility to report the audits findings directly to the Board. **See Finding 6.**

8. A Board audit committee should appoint and compensate the audit firm and ensure the rotation of the lead audit partner and the audit partner reviewing the audit, as required by the Sarbanes Oxley Act (SOX) for companies with publicly traded stock. (Though Dismas Charities is not a publicly traded company subject to SOX; this is a best practice that should be considered by boards of public and non-profit organizations.) The Board should also consider whether rotating audit firms would be beneficial given the facts and circumstance of the organization. Further, if possible, the Board audit committee should be comprised of at least one member who has an understanding of generally accepted accounting principles and financial statements, experience with internal controls and in preparing or auditing financial statements, and an understanding of audit committee functions, as suggested in Section 407 of SOX. In addition, reviews of internal controls should be conducted to ensure that controls are functioning as designed or needed. The review of internal controls could be conducted by an internal auditor, Board designee, or included in the engagement of an auditing firm. Any concerns noted by the Board should be disclosed to the auditor and included in the audit scope for review. **Not able to complete due to limited information and documentation provided. See Review of Dismas Charities' Expenditures later in this Chapter.**

9. The Board should adopt a code of ethics that includes standards of conduct for its Board members, officers, and employees related to business conduct, integrity, and ethics. The policy should include the requirement to sign a form stating that the individuals have received and understand the code of ethics. The code should include statements regarding moral and ethical standards, confidentiality, conflicts of interest, nepotism, gifts, honoraria, and assistance with applicable audits and investigations. Violations of the code of ethics should be reported to the Board or designated committee of the Board. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 5.**

10. The Board should adopt a financial disclosure policy for Board members and executive management. A policy should also be developed requiring Board members and executive management to disclose any conflicts of interests. The disclosure form should be completed by a specified date and returned to the appropriate committee of the Board. **Dismas Charities appears to have adequately complied with this recommendation.**

11. The Board should establish and approve a detailed, equitable personnel and compensation policy. The policy should include that the Board or a designated Board committee annually review the salary increases and bonus payments made to all staff. This review should be documented in the Board meeting minutes. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 4.**

12. The Board should define and document all employee benefits in a fair and equitable manner. Benefits received that result in taxable income should be properly accounted for and accrued to each applicable employee. Employee benefits should also be reviewed to ensure they provide a reasonable business purpose. Also, membership fees to organizations or associations should provide a reasonable business benefit. **Dismas Charities appears to have adequately complied with this recommendation.**

13. The Board should approve the compensation package of the organization's primary executive and be aware of the compensation provided to other Executive Staff. In determining the compensation for the primary executive, the Board should consider the organizations financial resources, current economic conditions, employee performance, and salary data for similar positions at relevant organizations within the region. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 4.**

14. The Board should ensure a well-defined employee evaluation system is implemented within the organization to consistently assess employee performance. The results of the employee's evaluation should be used for employee advancement or salary adjustments. **Dismas Charities appears to have adequately complied with this recommendation.**

15. The Board should adopt policies to ensure all forms of employee leave are properly approved and accurately recorded. **Dismas Charities appears to have adequately complied with this recommendation.**

16. The Board should have sick and vacation leave policies that address the accrual, use, and the payment to employees for any unused sick, vacation, or compensatory time. **Dismas Charities appears to have adequately complied with this recommendation.**

17. The Board policy should include a transparent, competitive selection process for the procurement of goods and services. The policy should outline the circumstances under which quotes or competitive bids are required and the process to be followed. The Board should have policies that require a formal contract for purchases over a specified amount and that all contracts over a specified dollar amount require Board approval. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 1.**

18. A review of budget to actual expenditures should be performed regularly by the Board or a designated Board Committee to monitor costs in each account. The name and number of budget categories or line items should provide transparency and sufficient detail to allow Board members to accurately identify the types of expenses being attributed to each category. If expenditures occur at an unexpected rate, additional detail should be requested to ensure that incurred expenditures are reasonable and necessary. **Not able to complete due to limited information and documentation provided. See Findings 1 and 3.**

19. At least quarterly, the Board or a designated Board committee should receive and review a listing of payments that includes, at a minimum, the payee, dollar amount, and date of each expenditure. This review would assist in identifying inappropriate, unusual, or excessive expenditures. **Not able to complete due to limited information and documentation provided. See Findings 1 and 3.**

20. Executive management traveling out of state should present their plans and estimated costs to the Board for prior approval. The approval of these activities and associated costs should be addressed at the Board meetings to ensure proper documentation in the minutes. Subsequent to attending approved conferences or activities, the amount expended should be reported to the Board. **See Finding 1.**

21. To minimize and control the cost of travel, a travel expense policy should be developed that specifically defines the allowable costs related to lodging, meals, entertainment, personal mileage reimbursement, rental cars, and airfare. The travel expense policy should state the invoice requirements for the reimbursement of certain expenditures such as taxi fees, tips, parking, or tolls. The policy should provide examples of expenditures that are to be paid for by the employee, such as costs incurred by family members or the attendance at events not approved by the Board. This policy should explicitly state that expenses not in compliance with the travel expense policy would not be reimbursed or paid by the Board. **Dismas Charities appears to have adequately complied with this recommendation.**

22. In lieu of credit cards, the Board should consider the following:

- * The use of purchasing cards that would allow the Board to restrict the types of purchases that can be made on the card based on industry codes. Casinos, specialty retail outlets, and food and beverage establishments are examples of these restrictions. The amount spent on a single purchase can also be restricted through the use of a purchasing card.
- * Reimburse employees personal credit card charges when the use is necessary. Procedures and supporting documentation requirements should be developed to facilitate this type of reimbursement. **See Finding 2.**

23. If the use of credit cards is needed, the Board should implement the following oversight controls:

- * A Board member or committee of the Board should be assigned to review, at a minimum, credit card statements of Executive Staff prior to payment.
- * Credit card charges should be supported by detailed receipts, documented business purpose, and supervisory approval. The employee should be responsible for the timely payment of any unsupported credit card charges or disallowed expenses.
- * Policies established by the Board should ensure that all review procedures are performed in a timely manner to avoid late fee and finance charges. **See Finding 2.**

24. Expenses classified as gifts or entertainment should be documented to include the name and title of the person(s) involved and a description of why the expense was needed and how it relates to business operations. **Not able to complete due to limited information and documentation provided.**

25. A policy related to reimbursements made by employees to the organization should be developed to ensure that any expenses that should be paid by an employee are monitored. This policy should include the timeframe allowed for making the reimbursement and the alternative actions that will be taken if reimbursement is not made. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 2.**

26. Business expense reimbursements requested by executive management should be reviewed by the Board or a designated Board committee to ensure supporting documentation is provided. This documentation should be retained to ensure that duplicate payments are not made to the employee. **See Finding 1.**

27. Specific marketing goals should be developed to monitor the success of any business promotions approved by the Board. Marketing expenditures incurred should be coded to that goal so that Board members will know the expenses involved in a specific marketing promotion. Further, documentation should be maintained detailing the recipients of promotional prizes including tickets, trips, or merchandise. **Not able to complete due to limited information and documentation provided.**

28. A Board policy should be developed to address the authorization process to purchase vehicles and the method used to dispose of vehicles. The use and assignment of vehicles owned by the organization should be addressed within this policy. In addition, the practice of providing a vehicle should be reviewed and monthly vehicle allowances considered. The policy should include following the IRS guidelines for personal use of a vehicle. **See Finding 2.**

29. The personal use of business equipment should be addressed within Board policy to determine when appropriate. The policy should require that equipment being used inappropriately or that is missing should be reported directly to the Board. **See Finding 2.**

30. The Board should establish a policy detailing the process to report lost or missing financial information or records. To avoid lost or stolen financial information, electronic images of financial records should be created and retained, if possible. **See Finding 2.**

31. A formal policy should be developed that identifies what equipment is a fixed asset and should be included as inventory. Once this designation has been made, the existing inventory listing should include the following identifying information related to each piece of equipment:

The name of the individual in receipt of equipment;

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Description of equipment;
Vendor name;
Model number;
Serial number;
Acquisition date; and,
Acquisition cost.

Once the inventory listing has been validated, any acquisitions and dispositions of computer equipment that fall within the fixed asset policy should cause an appropriate update to the inventory listing. **Dismas Charities appears to have complied with this recommendation, but further strengthening of the policy is recommended. See Finding 2.**

32. An information system policy should be developed that explicitly defines a user's responsibilities as they relate to information system resources and applications. These policies should cover, at a minimum:

- * Securing of user id and password;
 - * Protection against computer virus or mal-ware infection;
 - * Legal notice at logon indicating system is to be used for authorized purposes only;
 - * Securing unattended workstations; and,
 - * Securing portable devices, such as laptops, Blackberries, cell phones, etc.
- Dismas Charities appears to have adequately complied with this recommendation.**

Review of the Department of Corrections' Oversight and Monitoring of its Contracts with Dismas Charities

The Kentucky Department of Corrections, the state agency responsible for the housing of criminal offenders, held two separate contracts with Dismas Charities during the period of examination. The first, a Master Agreement contract, was a single contract with Dismas Charities for the housing of inmates at its seven halfway houses throughout the Commonwealth. Five of the houses are located in Louisville, one is in Lexington, and one is in Owensboro. The facilities provided by Dismas Charities must comply with all applicable federal, state and local land use, building and zoning codes, Corrections' policies and procedures, and special terms and conditions as set forth by the Parole board, as well as other requirements.

The Master Agreement is a firm fixed unit price contract, referred to by the Department of Corrections as a “no-bid” contract, whereby Corrections established “per diem” rates that it would pay for halfway house services, regardless of the provider of services. Since the 2006 per diem rates were established, the rates have been increased one time by 2.8 percent. The current per diem rates are as follows:

Table 3: Per Diem Rates for Halfway House

Female Inmate	\$32.64	Includes Medical Care
Male Inmate	\$31.61	Includes Medical Care
Parolee (Male/Female)	\$27.62	No Medical Care
* Halfway-Back (Male/Female)	\$38.36812	No Medical Care
Sex Offender	\$36.87	

Source: Information provided by Department of Corrections

* Returned Parolee

Any transitional care provider may enter into a contract with the Department of Corrections to provide such services. The Department of Corrections currently uses 23 different halfway house facilities throughout the Commonwealth, seven of which are Dismas Charities. In making the decision as to which facility to assign an offender, the Department of Corrections generally tried to evenly distribute the inmates to the various halfway houses. The Master Agreement contract provided no guarantee to the halfway house vendor as to the quantity of inmates that the Department of Corrections would send on a daily basis. The administration of this contract was handled by the Contract Management Branch within the Department. The amount that the Department of Corrections paid to Dismas Charities under the Master Agreement was based on the number of inmates housed at each facility per day, which was based on the needs of the Department. The basis for which the services were provided is contained in Kentucky Revised Statutes (KRS) 439.590.

The second contract, a Personal Service Contract, was a contract with Dismas for substance abuse treatment services. The contract, which was effective during the period of examination until June 30, 2010, was to provide an Extended Intensive Substance Abuse Treatment Program in Louisville as an alternative to incarceration. The program was to serve at least 125 state felony offenders on probation or parole in Jefferson County at any given point in time. The amount of the contract for fiscal year ending June 30, 2008 was \$245,813. The amount of the contract for fiscal years ending June 30, 2009 and June 30, 2010 was \$294,975 per year, totaling \$589,950 for the two-year period. The maximum allowable payment of \$24,581.25 was paid to Dismas Charities for 10 months during fiscal year 2008, and each month during fiscal years 2009 and 2010, for a total of \$835,763. See Table 4 detailing the contract amounts per service.

Table 4: Contract Pricing for Drug Treatment Program

Service	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010
Urine Screening	Detail	\$ 20,790.00	\$ 20,790.00
Facility Costs	not	105,793.50	105,793.50
Personnel	provided	143,642.00	143,642.00
Administrative	in contract	24,749.50	24,749.50
Total	\$245,813.00	\$294,975.00	\$294,975.00

Source: Personal Service Contract between Dept. of Corrections and Dismas Charities

Per the Kentucky Finance and Administration, the Department of Corrections made the following expenditures to Dismas Charities during the period of review.

Table 5: Department of Corrections' Payments to Dismas Charities

Fiscal Year	Halfway House Expenses (Master Agreement)	Drug Abuse Treatment Expenses (Personal Service Contract)	Other Expenses Paid to Dismas ³	Total Amount Paid to Dismas
2008	\$ 7,498,840	\$245,813	\$225,710	\$7,970,363
2009	7,686,622	294,975 ¹	73,442	8,055,039
2010	7,606,358	294,975 ²	72,000	7,973,333
Total	\$22,791,820	\$835,763	\$371,152	\$23,998,735

Source: E-MARS data

¹Last payment was made in July 2009 (FY 2010) for June 2009 contract services.

²Last payment was made in July 2010 (FY 2011) for June 2010 contract services.

³Other expenses included transportation costs, other professional services, inmate labor costs, medical/dental testing, and classroom supplies.

Compliance with Contracts

To ensure compliance with the Master Agreement and Personal Service Contract requirements and payment procedures, the APA reviewed the Department of Corrections' oversight and monitoring of Dismas Charities. The auditors documented the procedures in place regarding a system of oversight by the Department of Corrections, specifically oversight of contract requirements, and observed documentation verifying those procedures actually were carried out.

The Department of Corrections' procedures for ensuring compliance with the Master Agreement contract, which provided halfway house services, included both detailed inspections at the halfway house facilities and a thorough process for ensuring the accuracy of and support for payments made to Dismas Charities under the Master Agreement. The Department's two annual inspections of each halfway house, one announced and one unannounced, included a review of certain requirements listed in the Master Agreement. Also, the Contract Management Branch Manager and other Department officials visited certain halfway houses periodically during the year for additional oversight, looking specifically for compliance with certain requirements of the Master Agreement. Even so, the inspections conducted did not appear to be broad enough to ensure that all of the requirements specified in the Master Agreement were reviewed for compliance. See Finding 9 for recommendations regarding this matter.

The Department of Corrections' procedures for the payment of invoices to Dismas Charities under the Master Agreement appear to assure the people of the Commonwealth that proper controls exist over such expenditure of funds. Invoices were paid monthly upon receipt of documentation. Each month Dismas Charities forwarded to the Department of Corrections an invoice for each facility with a list of offenders served at the respective facility, along with the offenders' entry and exit dates, if applicable. Corrections staff compared that list to the Kentucky Offender Management System (KOMS) for accuracy, including accuracy of entry and exit dates for each offender. The Department paid Dismas Charities for the day of entry, but not for the day of exit for each offender. Accuracy checks included re-adding all the days charged and recalculating the per diem total for each facility, and the total paid to Dismas Charities.

The Department of Corrections' control procedures for ensuring proper payment of invoices under the Personal Service Contract, which provided an "extended intensive outpatient substance abuse treatment program," included a comprehensive verification process to confirm that the invoices were accurate and had supporting documentation. Invoices were paid monthly upon receipt of supporting documentation. Corrections' staff conducted several comparisons of numbers, checked for deliverables, and assured stipulations of the contract were being carried out.

**Review of Dismas
Charities'
Expenditures**

The APA made a conscientious attempt to determine whether the ultimate and specific use of state funds paid to Dismas Charities by the Department of Corrections was in keeping with its mission, was a reasonable and necessary expenditure of public funds, or was excessive or unusual. Dismas Charities provided to the APA certain organizational and financial documents listed previously in the Review of Dismas Charities Policies and Procedures section of this chapter. Nonetheless, the APA was restricted by Dismas Charities to reviewing only a limited area of expenditures, primarily the travel reimbursements made to employees at Kentucky facilities. Expenditures incurred at Dismas Charities' corporate office could not be examined because Dismas Charities declined to provide other financial information and documentation as requested by the APA.

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Documents Requested

The following documents were requested by the APA to complete its review of expenditures, but were not provided by Dismas Charities:

- Financial Statements for corporate headquarters;
- Financial Statements for individual Kentucky community correctional centers;
- Lists, records and documentation of income and expenditures made by corporate headquarters;
- Supporting documentation for public relations expenses;
- List and documentation of travel expenses by corporate office employees;
- List and documentation of reimbursements for corporate office employees;
- Breakdown of administrative expenses by corporate headquarters and individual Kentucky community correctional centers;
- List of gift and entertainment expenses for corporate headquarters with name and title of person involved and description detail of necessity of expense;
- Budgets approved by the Board for Dismas Charities for 2008, 2009, and 2010;
- Contract with and documentation of payments made to a company paid to “monitor the Kentucky Legislature on issues related to the state Department of corrections budget and matters related to half-way house and social rehabilitation residences;”
- Copies of consulting contracts;
- List of “consulting” expenditures paid during 2008-2010 – date of expenditure, to whom paid, and for what purpose;
- List of 2008, 2009, and 2010 Gala sponsors and amount of sponsorship;
- List of 2008, 2009, and 2010 Gala expenditures – date, to whom paid, and for what purpose;
- List of vendors during 2008, 2009, and 2010;
- Copy of letters sent out during 2008, 2009, and 2010 seeking participation by vendors in Gala (minutes, January 28, 2008);
- Work hours of staff provided for Gala; Dismas Attorney responded that staff hours worked for Gala were not recorded separately from normal work hours;
- 2008, 2009, and 2010 expenditures (date, amount) for the railroad Caboose used at University of Louisville football games;
- List of expenditures (date, vendor, amount, purpose) on Dismas’ Christmas Open Houses and House Holiday Tours for 2008, 2009 and 2010, and follow-up receptions; and,
- List of expenditures (date, vendor, amount, purpose) for Moonlight and Magnolias held on April 29, 2009.

While certain expenditure documentation regarding individual payment for travel and reimbursements by individual Kentucky facilities was provided, the APA was unable to ascertain that the expenditures reviewed included all expenses since Dismas Charities declined to provide the APA access to individual Kentucky facility financial statements, and thus expenditure totals could not be substantiated. Although requested by the APA, Dismas did not provide expenditure listings, documentation or financial statements of Dismas Charities' corporate headquarters. Thus, auditors were unable to review any expenditures made by corporate headquarters, including those discretionary expenditures related to sporting events at the University of Louisville and other entities. Also requested, but not provided, was any information as to the income or source of funds used for expenditures at corporate headquarters.

*Many Questions
Unanswered*

Furthermore, after an initial overview meeting between an APA auditor and Dismas Charities Executive Staff, Dismas Charities took a position of not allowing the APA to have any individual contact with Dismas staff during the conduct of the examination, other than with or through its outside attorney. The majority of the many questions that the APA had during the course of the examination were never sufficiently answered, limiting our ability to conduct a full review.

Without the information requested, the APA was unable to determine how state monies paid to Dismas were ultimately used, and whether such expenditures were a reasonable and appropriate use of public funds in keeping with the mission of Dismas Charities.

Findings as a result of the above detailed procedures are documented in Chapter 3, Findings and Recommendations, of this report.

Chapter 3

Findings and Recommendations

**Finding 1:
Dismas Charities
Board of
Directors' lack of
review and
approval weakens
control and
oversight
necessary for
accountability.**

During the examination of Dismas Charities, no evidence was found of any review or approval by Dismas Charities' Board of Directors of policy manual adoptions or changes, contract agreements for goods and/or services, Executive Staff travel expenditures, or certain financial matters, including budget to actual expenditures. A review of the minutes of Dismas Charities' Board of Directors meetings and other Board committee meetings, confirmed no documented record of the Board or any committee being advised of or approving actions regarding the above matters.

Dismas Charities is responsible for ensuring that the public monies it receives for services provided are used in a responsible manner that serves the interests of both the recipients of the Dismas' services as well as the taxpayers who ultimately fund the service. The lack of involvement by the Board in such matters indicates that the oversight and control over the responsible use and safeguarding of public funds expended by Dismas Charities is weakened.

*Review of Policy
Manuals and
Employee
Handbook*

In December 2010, the Dismas Charities' Human Resources Policies and Procedures Manual was revised with additional policies added. However, neither the Board, nor any Board committee, reviewed or approved the revised Human Resources Manual, the Policy Manual dated March 25, 2009, or the Employee Handbook dated October 23, 2009.

Without Board approval of changes in policy, the Board cannot be sure that its operating policies are consistent with, appropriate for, and supportive of the stated goals and objectives of Dismas Charities. Furthermore, Board oversight of Dismas Charities is hampered when it is unaware of policies and procedures required of its employees.

Contracts

Dismas Charities Fiscal Procedures Manual includes a "Competitive Procurement Procedure" that requires a minimum of two bids for goods and/or services in excess of \$1,000. The procedure waives the two bid process in cases of "emergencies" and also allows acceptance of the higher bid but requires a written justification be placed in the bid file. The Fiscal Procedures Manual also includes a "Contracts" procedure that states only the President/CEO or his designee is authorized to sign contracts on behalf of Dismas Charities. Neither the "Competitive Procurement Procedure" nor the "Contracts" procedure includes any provision for Board review or approval of contracts or the awarding of bids.

Chapter 3

Findings and Recommendations

The “Competitive Procurement Procedure” and the “Contracts” procedure do not include any guidance or instruction as to when or how the awarding of a competitive procurement bid should be formalized by a contract. Neither do the two procedures provide any guidance as to circumstances that would require Board notification or approval.

Without a requirement for board approval of certain procurements or contracts, accountability over the use of funds diminishes.

Executive Staff Travel

Dismas Charities’ travel policies do not require the Board to pre-approve out-of-state travel, charter air travel, first class air travel or an estimate of any associated travel costs to be incurred by Executive Staff. Additionally, the travel policy does not require Executive Staff to submit actual travel costs with supporting documentation of their expenses to the Board for review or approval.

According to Dismas Charities’ Executive Staff, there is no written policy in place for the use of charter air travel or first class air travel by the Executive Staff and/or Board members. Dismas staff stated, and the 2009 IRS Form 990 Schedule J indicates, that air charters are used when travel is required to multiple locations in one trip, due to the location of Dismas Charities facilities. Dismas Executive Staff suggests that it is easier to charter a plane for trips that require multiple stops and also states that the Board is made aware of any chartered plane usage. No documentation was found in the Board minutes provided by Dismas Charities to substantiate this claim.

Strong policies that provide for proper transparency and accountability would require Executive Staff traveling out-of-state to present their travel plans and estimated costs to the Board for prior approval, including the use of air charters or first class airfare. Strengthened policies would require the approval of these activities and associated costs to be addressed during Board meetings and properly documented in the Board minutes. Further, subsequent to attending approved conferences or activities, the amount expended would be reported to the Board for approval. When expenses of Executive Staff are not reviewed by the Board, the travel costs may exceed budgeted amounts and allow excessive spending.

The policies and procedures provided by Dismas Charities do not indicate the responsible party for reviewing and approving expense reimbursements to the Executive Staff. The Board, or a designated committee, should review Executive Staff reimbursement requests. See Finding 2.

Expenditure Review

Information provided to the auditors does not evidence that the Board compares the budget to actual expenditures for Dismas Charities. Furthermore, there is no documentation to indicate that the Board conducts any periodic review of expenditures, or categories of expenditures, to evaluate whether those expenditures may be reasonable and necessary, and to identify inappropriate, unusual, or excessive expenditures.

For transparency, strengthened policies would require the budget categories or line items presented to the Board to provide sufficient detail to allow Board members to accurately identify the types of expenses being attributed to each category. If expenditures occur at an unexpected rate, or appear to be inappropriate or unusual, Board members should request additional detail to ensure that incurred expenditures are reasonable and necessary.

Lack of this financial review oversight again weakens the internal controls within the organization of Dismas Charities and the accountability over the use of public funds is reduced.

Recommendations

We recommend that Board of Directors strengthen its policies to provide guidance and oversight for the operational aspects of Dismas Charities, including oversight of financial matters.

Specifically, our recommendations include the following:

- 1) We recommend that the Board review any adoption of, or changes to, Dismas Charities' policy and procedure manuals prior to implementation. Such review and approval should be noted in the Board meeting minutes. Changes to manuals should be reviewed and approved by the Board before new manuals are distributed to employees.
- 2) We recommend the Board establish policies that require a formal contract, and Board review and approval, for purchases over a specified aggregate dollar amount. We also recommend the Board be apprised of all contracts implemented in an "emergency" situation. We recommend when bidding is required, and the lowest bid is not accepted, or an "emergency" contract is approved, the Board be notified of the reasoning behind the decisions and the justification to be presented to the Board for review.
- 3) We recommend the Board, or a designated committee of the Board, pre-approve Executive Staff out-of-state travel, and estimated costs, including prior approval of chartered planes and first class airfare. The Board meeting minutes should document the review conducted by the Board. We also recommend the Board require a report of the actual travel expenses of Executive Staff, with Board approval, prior to expense reimbursement. The expense reports should sufficiently detail the expenses associated with meals, lodging, transportation, and entertainment of each trip, as well as the business purpose of each expense item.

- 4) We recommend that the Board, or a designated committee of the Board, perform a regular review of budget to actual expenditures to monitor costs in each account. The name and number of budget categories should provide transparency and sufficient detail to allow Board members to accurately identify the types of expenses attributed to each category. At least quarterly, the Board or a designated committee of the Board, should receive and review a listing of expenditures with sufficient detail to identify inappropriate, unusual or excessive expenditures.

The Board meeting minutes should document the exact nature and extent of the financial reviews conducted by the Board. Any issues that result from these reviews and any action taken to resolve the issues also should be documented.

Finding 2: Several of Dismas Charities' policies need strengthening to achieve greater accountability.

Dismas Charities has in place a comprehensive set of policies and procedures implemented to provide adequate internal controls and proper oversight and accountability of its organization. These policies and procedures are documented in a Fiscal Procedures Manual, a Policy Manual, a Human Resources Policies and Procedures Manual, and an Employee Handbook, the latter two of which include an acknowledgement form for the employee to sign stating he or she has received and has a responsibility to read and comply with the policies. The policies detailed within these manuals and the handbook provide information concerning work conduct, fiscal procedures, company structure, and outline the company's policies, programs, and benefits available. Nevertheless, in order to provide the accountability that is required for a nonprofit organization that receives a significant majority of its funds to operate from public sources, certain of the policies within these documents need to be strengthened.

Dismas Charities' written policies for travel expense reimbursement, equipment and vehicle usage, and property inventory provide some detailed guidance for employees, but are missing certain guidelines that are necessary for proper internal control and oversight within an organization. Dismas Charities stated that it has procedures regarding credit card use, although no written credit card policies exist in any of Dismas Charities manuals or Employee Handbook. Further, certain policies contained only in the Fiscal Procedures Manual may not have been available to all employees who need such information in order to comply with organizational policies.

*Expense
Reimbursement
Policies*

The Fiscal Procedures Manual offers a comprehensive reimbursement policy pertaining to staff travel expenses including airfare, vehicle mileage, meals, and lodging for in-state and out of state travel. The Human Resources Manual and the Employee Handbook provide a brief synopsis of on-the-job expense reimbursement procedures but do not reference the more detailed instructions provided in the Fiscal Procedures Manual.

Although there are detailed policies on travel reimbursement in the Fiscal Procedures Manual for monitoring travel expenses, including supporting documentation, those policies and procedures are not conveyed to staff through the Human Resources Manual or Employee Handbook. The Fiscal Procedures Manual does not appear to be made readily available to employees since there is no acknowledgment form in the manual. Given that there is no cross reference between the Fiscal Procedures Manual and the Human Resources Manual and Employee Handbook, employees may not be instructed on the proper procedures to use when submitting reimbursements for expenses.

Further, the auditors found no evidence of any policies for the following:

- Board review of executive management reimbursements;
- Timeframe for reimbursement; and,
- Duplicate payment avoidance.

Per the Fiscal Procedures Manual, all trips out of an employee's county require prior approval by the President/CEO, Executive Vice President, Regional Vice President/CEO, and/or the employee's Director. For trips requiring air travel, prior approval is required by the President/CEO, Executive Vice President, or Regional Vice President. In the auditors' review of the expense reimbursements for travel made by Dismas Charities to employees of Kentucky facilities, nothing unusual or excessive was noted. However, Dismas Charities declined to provide corporate level travel reimbursements, where questionable, discretionary travel is more likely to have occurred. Not all Kentucky facilities reimbursement documents submitted by employees contained the required approvals. In most cases, no supervisor signed the employee's Employee Trip Sheet/Expense Report, and only occasionally was the director's signature noted. Such signature approvals are required according to Dismas' policies. Further, no Dismas' policies or procedures exist requiring any Board review and approval of Executive Staff travel expense or reimbursement.

The requirements listed in Dismas Charities' policies relating to reimbursement expenses do not list a specific timeframe by which employees must submit their reimbursements. The Fiscal Procedures Manual references a bi-weekly timeframe to turn in mileage but no other instruction is provided to employees as to when other expenses for airfare, meals, and lodging must be submitted and reimbursement made. The Human Resources Manual and the Employee Handbook indicate that expenses should be submitted monthly, but set no limitation on reimbursement after a certain amount of time.

Strong internal controls for the safeguarding of funds require procedures to avoid duplicate payments. Without such procedures, invoices may be paid more than once creating a wasteful use of the organization's funds.

Chapter 3

Findings and Recommendations

Business Equipment & Vehicle Usage Policies

Dismas Charities has limited policies in the area of vehicles and personal use of business equipment. Dismas Charities Policy Manual provides the following policy regarding vehicle usage:

Vehicles owned by Dismas Charities, Inc. may only be operated by staff with valid driver's licenses. Dismas Charities, Inc. will maintain full insurance coverage on all vehicles. Coverage will be in conformance with state statutes. Vehicles will undergo safety inspections as required by state statutes. A system for maintenance and inspections will be established in accordance with the manufacturer's recommended guidelines. In the event a safety repair is needed, company vehicles will not be operated until repairs are made.

The Employee Handbook provides only minimal guidance on an employee's responsibility for the use and care of Dismas vehicles, mainly pertaining to using proper care and avoiding traffic violations. This policy also lacks detailed information concerning business equipment and/or vehicles, as it only instructs personnel to advise their supervisor of damaged or defective equipment or notice any vehicles with damage or defects. It advises "the improper careless, negligent, destructive, or unsafe use or operation of equipment or vehicles...can result in corrective action, up to and including termination of employment." No evidence was found concerning vehicle policies for:

- Authorization process for procurement of vehicles;
- Use and assignment of vehicles;
- Proper reviews; and,
- Internal Revenue Service (IRS) Guidelines for personal use of a vehicle.

The only reference in Dismas' policies to personal use of equipment states: "Employees must secure permission from Dismas Charities prior to the personal use of any office equipment. Such personal use, when permission is granted, will be restricted to non-working hours." The policy allows for personal use of equipment, which is restricted to non-working hours. Employees are to obtain permission for personal use, but the policy does not provide any stipulation as to what type of personal use is permitted.

The Fiscal Procedures Manual provides additional information for employees concerning the operation of Dismas owned vehicles. This manual states that Dismas Charities will be responsible for the insurance on the company vehicles and maintain safe vehicles for employee operation. No further information is provided in this policy to the employee regarding the use of company owned vehicles and no reference is made to the section in the Employee Handbook regarding the use of equipment.

In order to maintain proper internal controls and oversight of vehicles and equipment, policies should exist that require employees to provide a purpose, need, and use of the business equipment and/or vehicle.

Dismas Charities' policies do not discuss personal use of company vehicles. If Dismas Charities prohibits the personal use of company vehicles, then it should be clearly stated in the policy. If some personal use of company vehicles is permitted, the policy should include acceptable permissive use and follow the IRS guidelines for personal use of a vehicle.

Inventory Controls

Although Dismas Charities has some stated inventory policies, the policies have no requirement for annual or periodic inventory essential for determining if equipment is missing. Dismas Charities' property inventory and control policy does not provide for a periodic review or physical accounting of the company's fixed assets. The lack of periodic review of inventory can allow for inventory to be misused, misplaced, damaged, and possibly stolen. The Fiscal Procedures Manual includes a section for "Property Inventory and Control," which includes the following policies and procedures:

- All furniture and equipment costing more than \$500 when purchased or donated must be accounted for in the Agency Fixed Asset File.
- All such equipment may be inventoried periodically on the appropriate form.
- If the item is sold, destroyed, or no longer in repairable condition, it is recorded on the Inventory Control Form. If the item is lost or stolen, a report must be completed and submitted to the President/CEO, Executive Vice President, or Regional Vice President.
- Once it has been determined that the equipment has been lost or stolen, the matter may be reported to the police. The Report with a copy of the police report is retained in the Agency files.

No other policies were found in either the Employee Handbook or Human Resources Manual pertinent to inventory control. We were unable to determine if an inventory control officer exists or if the inventory control requirements were conveyed to staff that have roles in the recording of property inventory. Good internal control over property requires staff to perform a proper inventory review with a checklist of identifying information to be recorded. The list should include the following minimum information:

- The name of the individual in receipt of the equipment;
- Description of equipment;
- Vendor name and model number;
- Serial number;
- Acquisition date; and,
- Acquisition cost.

This type of checklist will assist in determining if the recorded inventory is accounted for or if items are missing. Inventory control procedures should be well defined to insure that all asset acquisitions and retirements are properly accounted for and approved. Once the inventory listing has been validated, any acquisitions and dispositions of equipment that fall within the fixed asset threshold should cause an appropriate update to the inventory listing. If any fixed assets are determined to be missing or damaged, a process to document the damaged items should be developed.

Recommendations We recommend all policies within Dismas Charities' Policy Manual, Employee Handbook, Human Resources Policies and Procedures Manual, and Fiscal Procedures Manual be consistent. All policies of which employees need to be aware for proper organizational control, oversight, and transparency should be included in the Employee Handbook and Human Resources Policies and Procedures Manual, both of which are available to all employees.

We recommend that a credit card usage and oversight policy be included in Dismas Charities' Policy Manual, Employee Handbook, Human Resources Policies and Procedures Manual, and Fiscal Procedures Manual detailing required supporting documentation, timely review by the Board or committee, and approval of Executive Staff credit card statements.

We recommend elements of specific Dismas Charities' policies covering travel expense reimbursement, equipment and vehicle usage, and property inventory be strengthened as detailed in the following recommendations:

- 1) We recommend the travel reimbursement policies included in the Fiscal Procedures Manual also be detailed in the written policies provided to employees, such as in the Employee Handbook and Human Resources Manual, so that employees will be informed of the proper procedures to follow when submitting requests for reimbursement of expenses. We further recommend that the reimbursement policy provide specific, consistent timeframes for employees to submit their requests for reimbursement of expenses. Any forms required to be used for the reimbursement process should be readily available to all employees. Dismas management should ascertain that proper approval of employee expense reports is given prior to any reimbursements made.

We also recommend policies be implemented to ensure that the Board of Directors or a designated committee review and approve all executive management reimbursements and supporting documentation to ensure the reimbursements are for reasonable and necessary expenditures. Such reviews and approvals also will help ensure that duplicate payments are not made.

- 2) We recommend that Dismas Charities further strengthen its equipment and vehicle usage policies by establishing policies that include an authorization process to purchase vehicles and method of disposal. The use and assignment of vehicles should be addressed within these policies.

We recommend policies stipulate when personal use of vehicles or equipment is acceptable. If Dismas Charities intends to prohibit the personal use of company vehicles, it should be clearly stated in the policy. If personal usage is allowed, then the policy should include acceptable permissive use of a vehicle. Dismas Charities has limited policies in the area of personal use of business equipment, and might want to consider expanding this area to provide more definitive guidance such as: who should approve, sign out of equipment, time limitations, etc. The policies also should include following IRS guidelines pertaining to use of a vehicle by an employee.

- 3) We recommend Dismas Charities expand its property and inventory control policies to incorporate an annual, or periodic, physical inventory of all fixed assets. We also recommend Dismas Charities develop a process to be followed by an employee when equipment is found to be missing, damaged, or inappropriately used. The property inventory and control policy should be made available to employees who have responsibility for property assets and should include sufficient procedural detail to insure accurate and appropriate accounting for property inventory. Dismas may want to accomplish this recommendation by including its inventory and property control policies in its Employee Handbook.
-

Finding 3: Dismas Charities spent funds on sporting and entertainment events with questionable benefit to its mission.

The mission of Dismas Charities is “to provide quality, cost-effective community-based supervision and treatment services to individuals within the criminal justice system.” Dismas Charities expended significant funds for Dismas sponsored and Board approved activities that had questionable benefit or that were not aligned with the stated mission. Specific questionable activities included leasing a suite at the KFC Yum! Center and at Papa John’s Cardinal Stadium, renting a hospitality “caboose” for the University of Louisville football games, financially sponsoring Bellarmine University’s basketball team, and hosting various social events including an annual Derby Gala, an annual Holiday Open House, and golf outings. Thus, questions arise as to whether the benefit received by Dismas Charities’ from such affiliations with the universities was comparable to the funds expended, and also whether the expenditures for the Galas, open houses, and golf outings were fundraisers or simply extravagant social events.

Findings and Recommendations

According to Dismas Charities Statement of Functional Expenses, contained in its 2009 IRS Form 990, Dismas expended over \$40 million in calendar year 2009. See Table 6 for a breakdown of those expenditures.

Table 6: 2009 Statement of Functional Expenses

	Fundraising Expenses *	Management and General Expenses	Program Service Expenses	Total Expenses
Compensation of Officers	\$ 0	\$1,207,499	\$ 0	\$ 1,207,499
Other Salaries and Wages	0	1,300,342	13,478,928	14,779,270
Pension Plan Contributions	0	2,400,000	0	2,400,000
Other Employee Benefits	0	130,495	576,806	707,301
Payroll Taxes	0	163,017	1,063,970	1,226,987
Occupancy	0	65,326	6,861,346	6,926,672
Travel	0	139,076	553,380	692,456
Interest	0	1,241	0	1,241
Depreciation, Depletion, Amortization	0	158,410	1,535,352	1,693,762
Telephone	0	56,413	211,178	267,591
Repairs, Maintenance, Supplies	0	121,448	1,961,235	2,082,683
Other Expenses	0	1,073,788	7,303,475	8,377,263
Total Functional Expenses	0	\$6,817,055	\$33,545,670	\$40,362,725

Source: 2009 IRS Form 990

* No expenses reported on the Form 990

Since the APA did not have access to the financial records detailing or supporting the above numbers, the APA was not able to perform a comprehensive review of expenditures to determine whether such expenditures were reasonable and necessary and in keeping with the mission of Dismas Charities. Thus, other questionable expenditures may or may not have existed. See page 20 for listing of documents requested by auditors but not provided.

Documentation to support these expenditures was not provided to the APA, nor was a breakdown between what was spent at various Dismas facilities versus what was expended by Dismas Charities' corporate office. Furthermore, the limited individual contact with Dismas staff concerning the use of funds left the APA with many unanswered questions pertaining to expenditures. Serious concerns were raised regarding Dismas Charities' use of public funds on entertainment and sporting events identified in this finding. Without the ability to directly interact with Dismas Charities' employees, Executive Staff, or the Board, and review corporate financial information, auditors were unable to document the appropriate use of these public funds.

Chapter 3

Findings and Recommendations

Suite Rental at the KFC Yum! Center and Papa John's Stadium

In January 2008, Dismas Charities' Board of Directors voted to financially support the stadium expansion and new arena projects at the University of Louisville. The initial contribution by Dismas Charities for the suites at the KFC Yum! Center and Papa John's Stadium was noted as \$100,000 to be paid over three to five years. Additionally, the annual cost of the suites at the expanded Papa John's stadium and the new downtown arena would be approximately \$120,000, (\$40,000 - 50,000 for football and \$80,000 for basketball). The arena suites were to have available seating for 16 with standing room for 12-18 people for all home games. The initial contribution and the annual amount would not include tickets for other events or other promotions held at the arena, although it would allow Dismas Charities the first opportunity to purchase tickets to other special events. The use of the suites was to be shared equally between Dismas staff and Dismas Board members for the "promotion" of Dismas Charities.

Although according to documentation reviewed, the Board believed that the expenditure for the suites could potentially create a negative public reaction since Dismas Charities was a non-profit agency, it countered by pointing out that it might positively elevate the company's stature as a strong corporate entity in the community.

In October 2009, Dismas Charities' President/CEO received, and was to sign, a request for a "commitment of support" to the University of Louisville. This "commitment of support" was for four years at a cost of approximately \$600,000. This "commitment" included 16 basketball tickets and 18 football tickets per game. Suite and ticket usage was encouraged as a means to raise the level of public awareness to the mission and work of Dismas Charities. It is unclear whether this "commitment of support" was an actual contract that the Board approved, but appears to be part of the "supporting the stadium expansion and new arena projects" approved in January 2008.

In September 2010, the University of Louisville reportedly offered to relinquish Dismas Charities from the leases for the KFC Yum! Center and Papa John's Cardinal Stadium and return the money Dismas Charities had given to the University related to the leases. The Board approved the decision to relinquish both suite leases. Although Dismas Charities used one of the football suites in early September, it asserted that all the money paid to the University of Louisville for the box seat tickets, \$155,786, was returned to Dismas Charities. However, no expenditure documentation, including that for the return of funds, was provided to the auditors.

Findings and Recommendations

*Caboose Rental at
Papa John's
Cardinal Stadium*

In 2010, Dismas Charities was in the third year of a five-year lease of a hospitality caboose parked behind the University of Louisville Papa John's Cardinal Stadium, with 16 tickets available for each home football game. A private company leased the converted caboose via five-year leases, for approximately \$15,000 - \$20,000 annually to Dismas Charities. Dismas staff, volunteers, community partners, and Board members utilized the caboose to gather and promote Dismas Charities. Occasionally, the Board allowed the use of the caboose to be auctioned to raise funds for other non-profit organizations. It is unclear how the use of funds to rent the caboose at University of Louisville football games is an appropriate use of public funds and how it ties back to the mission of Dismas Charities.

*Bellarmino
University
Sponsorships*

In October 2009, Dismas Charities accepted an opportunity to be the exclusive sponsor of the Bellarmine University basketball team for the 2009-2010 season. The sponsorship of \$16,500 was to provide recognition to Dismas Charities, potential speaking engagements, game tickets, and other opportunities. In addition, in November 2009, Dismas Charities became the sole sponsor of the Bellarmine University radio broadcasts. For the 2010-2011 basketball season, Dismas Charities remained a "Presenting Sponsor" for the Bellarmine basketball program.

The President/CEO of Dismas Charities is an alumnus of Bellarmine University.

Without additional explanation and expenditure information that Dismas Charities was declined to provide to auditors, it is again unclear as to how these sponsorships were an appropriate use of public funds and benefited the ultimate purpose of Dismas Charities to provide transition care services for offenders.

Annual Derby Gala

In conjunction with the Kentucky Derby festivities, Dismas Charities began hosting an annual Derby Gala in 1999. In 2008, the Gala had 11 corporate sponsorships and approximately 550 attendees, with a live band as well as a valet parking service. The 2008 Gala solicited over \$80,000 in corporate sponsorships, and had combined revenue with sponsorships, ticket sales, and silent auction proceeds of \$160,000. The Gala expenses were over \$123,000 as of May of 2008, with an expected profit for Dismas Charities of approximately \$33,000. Following the Derby Gala, Dismas Charities' President/CEO suggested the Board might want to consider not hosting a gala since the profit in recent years did not factor in the magnitude of work and man hours provided by a large number of staff. The Board appointed a committee to reevaluate the Derby Gala, but no evidence that the committee ever made a presentation or recommendation to the Board was found.

In 2009, Dismas Charities again hosted their Derby Gala. The Gala had a decrease in pledged sponsorships but no financial information, as to earnings or profits, was available to the auditors. A potential conflict of interest was noted, however, regarding solicitation for the Gala. See Finding 5.

In 2010, the Derby Gala was changed to an invitation only party for 250 to 300 guests. The downsized party was due to economic times and decline of sponsorships from the 2009 Gala. This Gala had a \$45,000 budget and was held the Saturday before the Kentucky Derby using a smaller tent. There were no ticket sales, nor solicitation of sponsorships, with cocktail attire and tux optional. The Board considered the 2010 Derby Gala celebration successful, even though they had to cut expenses. However, the expenses were listed at \$70,000, which was approximately 56 percent higher than the budget of \$45,000. Dismas Charities did receive \$14,000 in donations during the 2010 Derby Gala. Following this Gala, it was again recommended to reevaluate this fundraiser due to costs. The event, begun 11 years ago as a fundraiser, had grown into a “friendraiser,” according to documents reviewed.

If the Gala is not a successful fundraiser for the charity, the Board should reconsider whether it is a proper use of public funds and the benefit that the event provides for the mission of Dismas Charities.

*Annual Holiday
Open House*

Dismas Charities hosts an annual Holiday Open House in December for neighbors, staff, volunteers, Board members, and their families. In 2007, the Holiday Open House had over 700 guests. In 2008, the Holiday Open House was held at the Dismas Carrigan Center and was featured in the 32nd Annual Old Louisville Holiday House Tour. In 2009, no annual Holiday Open House was held by Dismas Charities due to flooding at their corporate offices. However, a party for the Board and Executive Staff was held at 610 Magnolia, a restaurant in Louisville. Cocktails and hors d’oeuvres were served to the attendees.

Information concerning the expenses of the annual Holiday Open Houses were not made available to the auditors. Thus, it is uncertain whether the cost of the elaborate affairs were reasonable and in keeping with the charge of Dismas Charities or with the use of public funds.

Golf Outings

Dismas Charities sponsored and supported multiple golf outings between 2008 and 2010. Some of the golf outings appear to be fundraisers for the charity, but others appear to be only for Board members, staff, and Derby Gala sponsors with cocktails and dinner provided.

Again, information concerning the expenses of the golf outing was not made available to the auditors. Thus, it is uncertain whether the cost of the golf outings were reasonable and in keeping with the charge of Dismas Charities or the use of public funds.

Recommendations A not-for-profit organization such as Dismas Charities that primarily receives public funds for services provided, and has a privileged tax status, has an obligation to the general public to spend such funds in a fiscally responsible manner. We recommend all expenditures made by a not-for-profit organization be an appropriate use of public funds and be tied to the ultimate mission of the organization, which in the case of Dismas Charities is to provide quality, cost effective, community-based treatment services and programs to individuals in the criminal justice system and assist them in becoming positive, productive members of their community.

We recommend Dismas Charities' Board of Directors develop policies that provide specific guidance for staff members on the proper use of Dismas Charities' financial resources that support Dismas Charities' mission. The Board should demonstrate a strong board commitment for the responsible and effective use of its funds. Procedures should be in place to review and monitor expenditures to ensure they are reasonable and necessary for Dismas Charities to carry out its mission. We recommend the Board emphasize to staff the importance of the proper use of publicly generated funds and ensure such funds are used in the best interest of the clients served.

As previously recommended, at least quarterly, the Board should perform a review of budgeted to actual expenditures for the corporate office, as well as for each individual facility, to monitor expenditures within each account. Budget categories should provide sufficient transparency and detail so that Board members can identify the types of expenses, such as sporting and entertainment events, attributed to each category, and whether such expenses are inappropriate, unusual, or excessive.

We further recommend that Dismas Charities' Board have clearly stated policies and procedures concerning fundraising. These policies and procedures should be supported and enforced by Board members and clearly communicated to staff.

Finding 4: Dismas Charities' Executive Staff received significant compensation through salaries, bonuses, and other provided benefits.

Dismas Charities' top three Executive Staff members include the President/Chief Executive Officer (CEO), the Executive Vice President(VP)/Chief Operating Officer (COO), and the VP of Finance/Chief Financial Officer (CFO). Salaries and bonuses paid to Dismas Charities top three Executive Staff members are detailed in Table 7. With the results of a compensation salary study finding Dismas Charities' top two executives at the top of the national range for all non-profit organizations, and ranked above the 90th percentile for transition care industries, such salaries are significant in relation to the mission and purpose of the organization. Further, although the Board's Personnel Committee approved the President/CEO's incentive bonus, Dismas Charities did not appear to have policies requiring the Board to review and approve compensation on an annual basis.

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Table 7: Executive Staff Compensation

Position	Year	Base Compensation	Bonus and Incentive Compensation	Other Reportable Compensation	Retirement and Other Deferred Compensation	Nontaxable Benefits	Total
President/CEO	2009	\$381,798	\$114,540	\$52,443	\$46,000	\$7,867	\$602,648
President/CEO	2008	\$381,798	\$114,540	\$44,528	\$45,000	\$14,800	\$600,666
Executive VP/COO	2009	\$302,384	\$88,937	\$24,707	\$46,000	\$7,927	\$469,955
Executive VP/COO	2008	\$296,455	\$86,346	\$17,204	\$45,000	\$8,062	\$453,067
VP/CFO	2009	\$176,020	\$51,771	\$14,899	\$46,000	\$9,669	\$298,359
VP/CFO	2008	\$172,568	\$50,263	\$5,844	\$45,000	\$13,067	\$286,742

Source: Dismas Charities' 2008 and 2009 IRS Form 990s

Policies

Dismas Charities' policies pertaining to compensation are detailed in its Policy and Human Resources manuals. The Personnel section in Dismas Charities' Policy Manual provides:

Employees will be hired to fill authorized positions at a specific salary level. Salary range increases and special merit pay increases will be granted within the limits of the agency's financial resources. The agency will seek to keep the compensation and benefit levels within competitive range with similar occupational groups within the local community taking into consideration that DCI is a premium pay employer seeking the most qualified individuals by providing above market compensation and benefits.

Dismas Charities' Human Resources Policies and Procedures Manual delineates the organization's hiring pyramid. Each facility director is responsible for recommending personnel budget needs regarding compensation. The "Compensation Administration" section of the Manual provides policies for position descriptions, entry level salaries, performance reviews, merit increases, Executive Staff bonuses, overtime, comp time, and other compensation matters.

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Regarding “Executive Staff Bonuses,” the Policy Manual states:

Executive staff and facility management are eligible to participate in the Executive Bonus Plan following the successful completion of one year employment in an executive or management level position. Specific information about this plan may be found in the Executive Bonus Plan document.

The Executive Bonus Plan document, which is simply a Bonus Calculation worksheet, details the bonus methodology for awarding bonuses to facility directors and assistant directors. It appears to be based on the savings of the respective center to both the total savings of the organization, and to the savings of previous years. A review of minutes documented that in 2009 the Personnel Committee and Board of Directors reviewed the methodology for awarding corporate staff bonuses and Center Directors and Assistant Directors bonuses.

Compensation Information Reported on IRS Form 990s

Dismas Charities reported to the IRS various salary compensation information on Form 990s it was required to file annually. Dismas Charities’ 2008 and 2009 Form 990s submitted to the IRS both assert on Schedule J (Compensation Information) that the organization used the following to establish the compensation of Dismas’ President/CEO:

- Compensation Committee;
- Independent Compensation Consultant;
- Form 990 of Other Organizations;
- Written Employment Contract;
- Compensation Survey or Study; and,
- Approval by the Board or Compensation Committee.

Both the 2008 and 2009 Form 990s assert that the compensation Dismas paid or accrued to the President/CEO, Executive VP/COO, VP Finance/CFO, or Directors (those listed on Form 990, Part VII, Section A) was contingent on its net earnings.

Dismas states in the Form 990s:

The organization has a two to three part incentive bonus compensation plan for three different categories of employees with the total bonus capped at a percentage of each employee’s wage base. The two parts are based on a favorable comparison to budget and performance. If the performance is favorable, the employees receive an additional prescribed percentage of their wage base as incentive compensation.

The 2009 Form 990s, Schedule O, Supplemental Information to Form 990, states the following by Dismas (and similar language for 2008):

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The CEO's compensation is reviewed and approved periodically by the compensation committee with any member who may have a conflict with respect to the compensation arrangement not being involved. Comparable compensation data for similarly situated organizations is used. Contemporaneous documentation and record keeping with respect to deliberations and decisions regarding the compensation arrangement are made by the committee and become a part of their permanent records. The compensation arrangement recommended by the committee is then presented to the entire Board of directors for approval. Additionally, the organization engaged the services of WTAS, LLC, an outside firm, to review the compensation program for both the CEO and Executive Vice President, who are the key employees listed in Part VII.

Compensation Study

Dismas Charities engaged a consultant to conduct a compensation study for the positions of President/CEO and Executive VP/COO, but not for the position of VP/CFO. In June of 2009, the study concluded the total direct compensation for 2008 of \$496,000 (President/CEO) and \$393,000 (Executive VP/COO) was not unreasonable even though the compensation for the President/CEO and Executive VP/COO averaged nationally above the 90th percentile compared to other transition care industries, and above the 85th and 80th percentile, respectively, when compared to all not-for-profit organizations.

The consultant benchmarked the total direct cash compensation (base and annual bonus) for the President/CEO and Executive VP/COO of Dismas Charities to survey data for other not-for-profit organizations.

The compensation study provided information as summarized below:

Background: To gain a clear understanding of the duties and responsibilities of Dismas' executives, the consultant met with the President/CEO, Executive VP/COO, and VP/CFO, and reviewed current job descriptions and detailed duties with respect to the compensation of the President/CEO and Executive VP/COO (second highest paid officer). Dismas Charities is a national provider in the residential community correction and human services industry, which is unique and highly competitive. Most other similar organizations operate in only one to three states. Dismas operates a much larger and diverse organization, with gross revenue of \$45 million in 2007. Dismas Charities management team has been in place for many years. Dismas has maintained a streamlined management team, and the President/CEO and Executive VP/COO are skilled in finance, human resources, insurance, and complex state and federal regulations. They are involved in all aspects of the operations of the Dismas Charities facilities, and are recognized experts in the industry.

Methodology: The compensation review compared the total direct cash compensation of the two executives to executives with comparable organizations in the similar field of service as Dismas Charities. For purposes of benchmarking, the consultant assumed that corporate goals, entitling the executives to their annual bonus, would be met at the target level. Due to the vast experience of the President/CEO and Executive VP/COO, and Dismas Charities' leadership role in the industry, as well as its innovations for the industry, it was difficult for the consultant to find direct comparable organizations. As such, the annual compensation was benchmarked using Economic Research Institute's (ERI) Executive Compensation Assessor Survey (dated January 1, 2009) and salary data received from the Mercer Human Resources 2008 executive compensation survey. ERI conducted surveys, extracted compensation data from publicly filed government records, collected all available salary and cost-of-living data, gathered data available via web services, job boards, and other new technologies, leased data from other survey vendors, and prepared reports and software analyses. ERI calculated the minimum and maximum ranges for each position based upon calculations using standard deviations.

The survey data was collected based on not-for-profit organizations with \$50 million and \$100 million in revenue. The auditors note that the annual revenue for Dismas Charities was closer to \$40 million per year. In addition, the information was sorted by "all" not-for-profit organizations and by organizations in the "transition care" industry. The survey information was reported on a national basis. For additional comparison, survey information was obtained for "transition care" as well as "not-for-profit" organizations located in Kentucky and Illinois. Data was aged to February 2009 at three percent.

For survey matches, the consultant captured median reported compensation data, as well as compensation for the 25th, 75th, and 90th percentiles, to obtain a reasonable range for the analysis. The job title used as a match for the position of Executive VP/COO was the "second highest paid officer" of the organization, although job responsibilities may not always correlate.

Benchmarking of Dismas' Executive Positions: The consultant benchmarked the total direct cash compensation of the President/CEO and Executive VP/COO to market data, after establishing a reasonable range based on the 25th, 50th, 75th, and 90th percentiles of comparables. Cash compensation amounts were used as follows:

- President/CEO - \$496,332 (Base Salary + Annual Bonus Opportunity of 30 percent); and,
- Executive VP/COO - \$393,099 (Base Salary + Annual Bonus Opportunity of 30 percent).

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President/CEO and Executive VP/COO Comparative Total Direct Cash Compensation: The ERI survey data for the President/CEO and the Executive VP/COO (second highest paid officer) reflected the following in Table 8:

Table 8: Summary of ERI Survey Results for President/CEO and Executive VP/COO

Area	Revenue *	Industry	Position	Compensation Percentile Rank
National	\$50 million	Transition Care	President	Above the 90 th
National	\$50 million	All Not-for-Profit	President	Close to the 90 th
National	\$100 million	Transition Care	President	Above the 75 th
National	\$100 million	All Not-for-Profit	President	Close to the 75 th
Kentucky	\$50 million	All Not-for-Profit	President	Significantly above the 90 th
Illinois	\$50 million	All Not-for-Profit	President	Close to the 90 th
Kentucky	\$100 million	All Not-for-Profit	President	Between the 75 th and 90 th
Illinois	\$100 million	All Not-for-Profit	President	Between the 50 th and 75 th
National	\$50 million	Transition Care	COO	Significantly above the 90 th
National	\$50 million	All Not-for-Profit	COO	Between the 75 th and 90 th
National	\$100 million	Transition Care	COO	Significantly above the 90 th
National	\$100 million	All Not-for-Profit	COO	Close to the 75 th
Kentucky	\$50 million	All Not-for-Profit	COO	Significantly above the 90 th
Illinois	\$50 million	All Not-for-Profit	COO	Above the 90 th
Kentucky	\$100 million	All Not-for-Profit	COO	Above the 90 th
Illinois	\$100 million	All Not-for-Profit	COO	Above the 90 th

Source: Compensation study

* Since the annual revenue for Dismas Charities is closer to \$40 million, the most comparable rankings would be those using \$50 million in revenue.

The Mercer survey, which only covers the 25th, 50th, and 75th percentiles, reflected the President/CEO ranked somewhat higher than the 75th percentile when compared to CEOs within national transition care industries. The Executive VP/COO ranked significantly above the 75th percentile when compared to other “second highest paid officers” of national transition care industries.

Using only the \$50 million revenue comparison, the following table compares the total direct cash compensation for the President/CEO and Executive VP/COO with the ERI survey info and identifies the closest approximate percentile for Dismas salaries.

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Table 9: President/CEO and Executive VP/COO Compensation Rankings

Area	Industry	Revenue	President/CEO	Percentile	Executive VP/COO	Percentile
Dismas	Transition Care	\$40 million	\$496,332		\$393,099	
National	Transition Care	\$50 million	\$479,130	90 th	\$256,523	90 th
National	All Not-For-Profit	\$50 million	\$480,656	85 th	\$390,730	80 th
Kentucky	All Not-For-Profit	\$50 million	\$443,590	90 th	\$339,797	90 th
Illinois	All Not-For-Profit	\$50 million	\$513,127	90 th	\$388,823	90 th

Source: Compensation study

The consultant concluded that the total direct cash compensation of \$496,000 (President/CEO) and \$393,000 (Executive VP/COO) was in the 75th percentile or higher of not-for-profit organizations with revenue of \$50 to \$100 million, but not unreasonable due to their experience and expertise.

The executive compensation reported on the IRS Form 990 for the President/CEO in 2008 and 2009 was over \$600,000 for each year, with his base salary as \$381,798, his bonus and incentive compensation as \$114,540; and with other reportable compensation, retirement and deferred compensation, and nontaxable benefits as listed in Table 10 below. However, the compensation study uses only the base salary and bonus of the President/CEO and Executive VP/COO for comparison purposes.

Table 10: President/CEO and Executive VP/COO Compensation

Position	Year	Base Compensation	Bonus and Incentive	Other Reportable Comp *	Retirement and Deferred Comp *	Nontaxable Comp *	Total
President/CEO	2008	\$381,798	\$114,540	\$52,433	\$46,000	\$7,867	\$602,648
President/CEO	2009	\$381,798	\$114,540	\$44,528	\$45,000	\$14,800	\$600,666
COO	2008	\$302,384	\$88,937	\$24,707	\$46,000	\$7,927	\$469,955
COO	2009	\$296,455	\$86,346	\$17,204	\$45,000	\$8,062	\$453,067

Source: Dismas Charities, Inc. Form 990

* Salary information not used in salary study for comparison purposes – only direct cash compensation compared.

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Although the consultant's study above documents a salary review by the Board in 2009, there was no evidence of annual salary reviews by the Board. The Personnel Committee did conduct annual incentive (bonus) reviews for the President/CEO.

Board and Committee Approvals

The Personnel Committee periodically reviewed the compensation and benefit package for the President/CEO. In 2008, the Personnel Committee recommended, and the Board of Directors approved the maximum 30 percent incentive bonus be awarded to the President/CEO. In late 2009, the Personnel Committee discussed and finalized the variable incentive portion of the President/CEO's annual compensation package. In 2010, the Personnel Committee conducted its annual incentive review for the President/CEO. The President/CEO was eligible for a 13.8 percent incentive payment, which was approved by the Committee based on organizational growth in net savings over the preceding year and achieving/exceeding budgeted savings in the current year.

Although it appears that salary increases and bonuses for President/CEO were reviewed periodically by the Personnel Committee, the auditors could not find any evidence that included a "requirement" for salary increases and bonuses to be annually reviewed by the Board or a committee and be documented in the minutes.

In light of Dismas Charities' mission to provide quality, cost effective, community-based treatment services and programs to individuals in the criminal justice system and assist them in becoming positive, productive members of their community, it is questionable whether Dismas has made the best and appropriate use of funds in the compensation of its Executive Staff. With the results of the salary study finding Dismas Charities' top two executives at the top of the national range for all non-profits, averaging above the 90th percentile for the transition care industry, such salaries may be considered excessive and disproportionate and perhaps a better use of public funds could be exercised.

Recommendations

We recommend Dismas Charities Board of Directors adopt a policy to review and approve the salary and bonus incentives of the Executive Staff on an annual basis to ensure that the compensation paid is equitable to the responsibilities and duties of each position. The salaries should be reviewed specifically by the Board to ascertain appropriate use of public funds given the mission of Dismas Charities. Salaries should be fair and equitable for all staff members.

We recommend the Board of Directors have involvement in the overall budget process for Dismas Charities, including approving the use of any "net savings." Any excess funds derived from efficiencies and incentive goals should be allocated to areas that support the appropriate use of public funds and the ultimate purpose of Dismas Charities to provide transitional services to assist persons released to the community from a correctional institutional.

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Finding 5: Dismas Charities ethical policies for Board members, officers, and employees do not cover all areas of standards.

Although Dismas Charities By-laws, Human Resources Policies and Procedures Manual, and Employee Handbook contain many sound ethical policies, the policies do not address solicitation of vendors or employee use of Dismas Charities' property and equipment. Further, policies for investigating unethical activity and criteria for sanctions or disciplinary procedures are not detailed.

Ethical Standards

Article V of Dismas Charities' By-laws provides the following:

Each officer and member of the Board shall avoid having a financial interest, directly or indirectly, in any transaction in which the Corporation is a participant, the adoption of which might affect, or might appear to affect, the exercise of his official judgment. Should an officer or member of the board identify the possibility of any such interest, it shall be reported in full detail in writing to the President and shall be read at the next regular meeting of the Board. Such person shall not vote on a subject in which he or she has such an interest. Failure to disclose the details of any such interest shall render void at the option the Board any obligation of the Corporation in regard to such transaction. Each member of the Board shall sign a Conflict of Interest Statement upon initial appointment to the Board.

Further, Article VII of the By-laws binds each director of the Board to various policy statements, including, but not limited to:

- Use of position to secure special privileges or advantages;
- Allowing personal interest to impair objectivity in the performance of duty;
- Use of official position to promote partisan political purposes;
- Acceptance of gifts or favors to imply an obligation that is inconsistent with the free and objective exercise of corporate responsibilities;
- Personal views versus statements made on behalf of the corporation;
- Reporting of corrupt or unethical behavior that could adversely affect the corporation;
- Confidential information; and,
- Corporate personnel actions based on merit and not in furtherance of partisan political or personal interests.

The 2008 and 2009 Form 990s, Schedule O, Supplemental Information to Form 990, state the following by Dismas Charities:

“The entire Board of Directors and key employees complete a conflicts questionnaire during the first Board meeting each year and they are instructed to report any subsequent potential conflicts that may arise during the year to the CEO.”

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Code of Conduct

In addition to the ethical provisions previously stated, the Board of Directors and officers have a “Code of Conduct,” according to a key Executive Staff member. However, the only code of conduct found was in the new Human Resources Policy and Procedures Manual, dated December 2010, and it appears to be applicable to employees only; nowhere does it state it is applicable to Board members.

This code of conduct, the Dismas Charities Code of Ethics, requires the following of officers and employees:

1. Each employee has an obligation and responsibility to immediately report any unethical conduct (intentional or not) to a member of management and/or the employee Hotline.
2. Each employee may be required to complete and sign a conflict of interest Certification form once a year – which will include a section addressing Dismas’ Code of Ethics.

However, another section of the Manual states, “[e]ach employee shall complete a Conflict of Interest Certification upon hire.”

The employees’ standards of conduct listed in the Human Resources Policies and Procedures Manual include (but are not limited to) provisions covering the following ethical issues:

- General Conflicts of Interest;
- Reporting of Unethical Conduct;
- Legal Compliance;
- Workplace Relationships with Clients, Other Employees, etc.;
- Favoritism;
- Use of Position to Obtain Privileges;
- Use of Position for Personal Gain for Employee, Friend, or Relative;
- Confidentiality;
- Employment of Relatives;
- Owning or Acquiring any Interest in Property, Contract, or Proposed Contract that poses a Conflict;
- Outside Employment;
- Employee’s or Board Members Personal Interests or Relationships;
- Outside Activities;
- Whistleblower/Hotline; and,
- Discipline/Sanctions.

Thus, the By-laws, Human Resources Policies and Procedures Manual, and Employee Handbook appear to contain sufficient sound ethical policies for Dismas Charities' Board members and employees. Policies for Board members covering use of position to gain an advantage, personal interest in performance of duty, promotion of partisan political purposes, acceptance of gifts, reporting of unethical behavior, use of confidential information, and criteria for personnel actions are addressed in the By-laws, but these do not appear to apply to officers and employees of Dismas Charities. However, the code of ethics in the Human Resources Policies and Procedures Manual, and several sections relating to ethical conduct in the Employee Handbook, do apply to employees and officers, and contain several ethical standards of conduct and reporting procedures, listed previously.

*Reporting
Allegations*

Policies within the Human Resources Policies and Procedures Manual direct employees to report concerns regarding the propriety or legality of an action or contemplated action relating to Dismas Charities to his/her primary manager or the next level of management. A hotline also exists for employees to report illegal and unethical behavior by Dismas Charities, its leadership, or others with respect to Dismas. If direct reporting to management is not appropriate or does not result in the concern being properly addressed, the employee may report his/her concern to any Executive of the corporation. Those policies, though, have no provisions for reporting improprieties directly to the Board. See Finding 6.

Furthermore, no policies existed for Board members or employees addressing solicitation and use of Dismas Charities property and equipment.

Solicitation

The lack of a policy regarding solicitation of vendors allowed Dismas Charities to solicit corporate sponsorships for its annual Gala held during the Kentucky Derby festivities from vendors with which it does sizable business. Such solicitation may create a conflict of interest for Dismas Charities in its selection of vendors.

The 2008 Dismas Charities' Board meeting minutes reflect that a second solicitation letter was to be sent regarding corporate sponsors for its Derby Gala seeking "to involve more participation from Dismas Charities' vendors." In March of 2008, \$80,000 in Gala corporate sponsorships was reportedly obtained. Significant Gala expenditures were reported as made in May of 2008, with a net profit of \$33,000. The "extreme" importance of "sponsorships" to the Gala's profitability was discussed. The President/CEO shared his concern about a conflict of interest in his soliciting sponsorships for the Gala and serving as President/CEO.

In 2009, a decrease in pledged sponsorships for the April 29, 2009 Gala was reported, however "Stites & Harbison," Dismas Charities' primary legal vendor, and "KiZAN Technologies," Dismas' primary software vendor, were recognized as Signature Sponsorships. Dismas Charities paid Stites & Harbison \$247,413 in 2009, and it paid KiZAN Technologies \$626,370 in 2008 and \$400,931 in 2009.

Without a solicitation policy to address the solicitation of vendors, there is an increased risk that the selection of vendors may be made based on the size of a vendor's donation to the organization, rather than on sound procurement policies, which may create a conflict of interest.

Recommendations Although we believe the standards of conduct for Board members, officers, and employees are relatively strong as written in Dismas Charities' Human Resources Manual and Employee Handbook, we recommend Dismas Charities strengthen its policies to include provisions addressing the following:

- Solicitation of Vendors; and,
- Personal Use of Dismas Charities Property/Equipment.

Such policies should include that any Board members and employees involved in the solicitation or acceptance of donations from vendors should have no responsibilities in the selection and oversight of Dismas Charities vendors.

In order to ensure compliance with Dismas Charities' code of conduct and ethical policies, we recommend Dismas adopt policies, procedures and responsibilities for investigating reported ethical misconduct and criteria for sanctions or disciplinary procedures.

Finding 6: Dismas Charities' whistleblower policy does not provide an avenue for employee concerns to be brought directly to the Board.

Although Dismas Charities has a written whistleblower policy in both its Human Resources and Procedures Manual and its Employee Handbook, neither version includes procedures that provide a method for employees and/or volunteers at any level, to bring their concerns directly to the Board.

Dismas' policies include an open door policy that encourages anyone to discuss problems openly with management. The policy allows for any concerned party to file a report directly to their primary manager or any Executive of the Corporation. The whistleblower policy offers an employee hotline service as one method for employees to report their concerns either by calling a toll-free hotline number or by visiting an established website to report their concerns. Reports filed through the hotline are directed, via a third party, to the Regional Vice President and the Executive Vice President. There was no indication of any notification made to the Board of hotline concerns. Further, Dismas Charities has no internal audit function that investigates and examines issues assigned by the Board of Directors and that reports directly to the Board.

According to The Human Resources Policies and Procedures Manual, the whistleblower policy was established to allow directors, officers, employees, volunteers, and other agents to raise their concerns with respect to the Corporation. The policy offers three ways to report a concern, either to a manager, to a member of the Executive Staff, or through the employee hotline service, but the policy does not provide a means for Board members to directly be made aware of concerns or issues.

The Employee Handbook's whistleblower policy offers the same reporting procedures, although it does not include some of the terminology explaining why the policy was established. The "whistleblower" sections of the Human Resources Policies and Procedures Manual and Employee Handbook do not provide any detail as to how the employee hotline service administrator handles complaints, but the details are provided in the "employee hotline" section of the manuals. According to the employee hotline policy, complaints are confidential and employees who use the service may remain anonymous. A third party administrator receives and reviews the content of the complaint, and subsequently contacts the Regional Vice President and Executive President to discuss and recommend a course of action. The policy does not require the third party administrator to submit the complaints, concerns or a summary of the issues received to the Board.

In addition to the whistleblower and employee hotline policies, the Employee Handbook delineates an open door policy. This policy allows an employee to bring concerns to his or her immediate supervisor's attention. If the employee's concerns cannot be resolved by his or her immediate supervisor, those concerns are then forwarded to the Regional Vice President. The employee hotline is again highlighted in this open door policy.

Dismas Charities also stated that its external auditors have explained that any issues they find they will bring to the attention of the proper level in the management chain of command.

Although Dismas Charities offers whistleblower policies, an employee hotline service, and an open door policy, none of the policies allow employees to take their concerns to the Board directly or give any indication that the Board is made aware of any whistleblower activity. Without a method for employees, volunteers, or others to ensure the Board is aware of the concerns or to report potential violations of policy or other matters directly to the Board, the Board may be unaware of the environment within the organization and unable to ensure a proper follow-up to investigate reported complaints is performed, specifically regarding any reported regional and Executive Staff issues. In order for the Board to be well-informed of employee and other concerns, the Board must be notified, independent of management, of certain complaints or allegations of policy violations that concern both regional and executive management issues.

Findings and Recommendations

Recommendations We recommend Dismas Charities strengthen its whistleblower reporting policies by creating and documenting an independent process whereby employees and/or volunteers have the option to directly make the Board aware of concerns involving matters that specifically need Board oversight. We recommend the Board establish methods that allow for concerns to be reported directly to their attention by all staff, including anonymous concerns, and any complaints against Executive Staff. Such methods could include the use of the current hotline, but with an option that allows the complainant to request the matter be reported directly the Board.

We recommend the Board further develop a process by which concerns are brought to the attention of the Board and ensure a process exists to analyze, investigate and resolve issues brought to its attention. An internal audit function could be used to ensure that concerns brought to the Board are independently investigated. The internal auditor should report findings directly to the Board.

Finding 7: Dismas Charities' Board members received no formal orientation regarding their legal and fiduciary responsibilities.

During the examination, auditors were unable to locate any documentation stating that an orientation for Board members is required or provided. The Board By-laws and meeting minutes do not reference a required orientation process when new members are sworn in. Dismas Charities' Executive Staff indicated that there is an annual orientation program consisting of written materials, facility tour with question and answer sessions, and informal information for new and returning Board members. However, no documentation of such a program or manual was provided or evidenced during the examination.

Members of the 12-person Board of Directors serve three-year terms without term limitations. New Board members that are elected may not be familiar with the Board's responsibilities, or with Dismas Charities' structure, programs, or personnel. New appointees may not have an understanding of their responsibilities as Board members and, absent a detailed orientation, it is difficult for a Board member to perform his or her responsibilities effectively. New Board members may be apprehensive or intimidated without a proper understanding of the organization and their responsibilities and may not ask pertinent questions or enter into discussions on significant issues.

To effectively perform their responsibilities and to benefit the organization, Dismas Charities' Board members should receive a formal orientation to ensure each Board member understands the organization, his or her role and responsibility as a Board member, and purpose of the Board and related committees on which he or she serves.

Recommendations We recommend the Board provide annual orientation training for new and returning Board members to ensure the members have at a minimum, a clear understanding of the Dismas Charities' organizational structure and policies, their responsibilities as Board members, as well as their legal and fiduciary roles, and the purpose of the board on which they serve. In addition, the orientation should address ethical requirements of Board members and staff and any significant policy changes adopted by Dismas Charities during the previous year.

Material for the orientation should be written and formally presented in a manual to facilitate the orientation process and serve as a useful reference tool for Board members. The orientation manual should provide a description of Dismas Charities structure, its revenue and investment information, as well as all ethics policies for Board members and staff of Dismas Charities. We also recommend that the orientation be facilitated by a knowledgeable independent party, such as a Board attorney who can participate in and oversee the orientation training.

We further recommend that upon completion of orientation Board members sign a statement attesting that they have attended the orientation and received and read the orientation manual. Dismas Charities should retain the signed statements as documentation of the Board members' attendance.

Finding 8: The Department of Corrections' Master Agreement with Dismas Charities does not contain standard contract language authorizing the APA access to the contractor's records.

The majority of funds paid by the Department of Corrections to Dismas Charities were paid through a Master Agreement contract for halfway house services; however, that contract did not contain standard state required language that authorizes the APA or other Kentucky state agencies to access the contractor's records. This includes access to accounting records, documents, and other evidence. A separate Department of Corrections contract with Dismas Charities for a substance abuse treatment program, however, did allow such access to certain Dismas records.

The Master Agreement between the Department of Corrections and Dismas Charities, initially signed in June of 2006, with the most recent renewal effective July 1, 2010-June 30, 2012, provided halfway house space for inmates at seven locations within the Commonwealth. The Department of Corrections paid over \$7,000,000 annually to Dismas Charities under this Master Agreement, as shown in Table 11.

Both the initial Master Agreement signed in 2006, and the most recent Master Agreement for fiscal years ending 2011 and 2012, have limited language regarding the authorization of records for inspection. Section 1.140 – Monitoring and Inspections (2006 Master Agreement), and under Section 30.140 – Monitoring and Inspections (2011 Master Agreement), both provide the following:

“Facilities will be subject to inspections at least twice a year. One (1) inspection shall be announced (schedule) and one (1) shall be unannounced. These inspections shall be conducted by the staff of the Department of Corrections' Contract Management Branch. (See attached Policy and Procedure 25.6)

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Periodic scheduled and unannounced inspections/audits of the facility and all records may be conducted during the term of the contract by employees of the Kentucky Corrections Department **or its agents**. Any questions concerning the scope of the inspections shall be addressed to the Community Program Administrator.” (*Emphasis added.*)

Table 11: Department of Corrections Payments to Dismas Charities

Fiscal Year	Halfway House Expenses (Master Agreement)	Drug Abuse Treatment Expenses (Personal Service Contract)	Other Expenses Paid to Dismas ³	Total Amount Paid to Dismas
2008	\$ 7,498,840	\$245,813	\$225,710	\$7,970,363
2009	7,686,622	294,975 ¹	\$ 73,442	\$8,055,039
2010	7,606,358	294,975 ²	72,000	7,973,333
Total	\$22,791,820	\$835,763	\$371,152	\$23,998,735

Source: E-MARS data

¹Last payment was made in July 2009 (FY 2010) for June 2009 contract services.

²Last payment was made in July 2010 (FY 2011) for June 2010 contract services.

³Other expenses included transportation costs, other professional services, inmate labor costs, medical/dental testing, and classroom supplies.

However, a supplemental contract between the Department of Corrections and Dismas Charities, effective for the fiscal year ending June 30, 2010, for the provision of a substance abuse treatment program did contain language allowing the APA to have access to records that are directly pertinent to the contract for purposes of financial audit or program review. The Department of Corrections paid nearly \$250,000 during fiscal year 2007-2008, and nearly \$300,000 in fiscal years 2008-2009 and 2009-2010, for services under this contract, as noted in Table 11.

Specific authorizing language in the contract includes:

The contractor, as defined in KRS 45A.030(7), agrees that the contracting agency, the Finance and Administration Cabinet, **the Auditor of Public Accounts**, and the Legislative Research Commission, or their duly authorized representatives, shall have access to any books, documents, papers, records, or other evidence, which are directly pertinent to this contract for the purpose of financial audit or program review. Furthermore, any books, documents, papers, records or other evidence provided to the contracting agency, the Finance and Administration Cabinet, **the Auditor of Public Accounts**, and the Legislative Research Commission which are directly pertinent to the contract shall be subject to public disclosure regardless of the proprietary nature of the information, unless specific information is identified and exempted and agreed to by the Secretary of the Finance and Administration Cabinet as meeting the provisions of KRS 61.878(1)(c) prior to the execution of the contract. The Secretary of the Finance and Administration Cabinet shall not restrict the public release of any information which would otherwise be subject to public release if a state government agency was providing the services. (*Emphasis added.*)

It is unclear why language authorizing the APA and other state agencies access to records pertinent to a contract where the Department of Corrections spent less than \$300,000 annually, would also not be included in a contract where the Department spent over \$7 million per year. The Department of Corrections asserted that such language was not required because the Master Agreement was a “no-bid” contract. However, per the Finance and Administration Cabinet, the language above should be in all contracts, including Master Agreements issued by the Commonwealth. According to a Finance and Administration official, “it is clear that it was an inadvertent mistake that the standard language allowing or authorizing the Auditor of Public Accounts to have access to records, books, and other evidence pertinent to the contract was not included.” This omission severely limits the ability to monitor and audit Dismas Charities’ operations.

Recommendations

We recommend that all contracts between the Department of Corrections and Dismas Charities, including no-bid contracts, provide language to allow the APA and other appropriate state agencies access to all pertinent contractor’s records including, but not limited to, accounting records, documents, papers, records, or other evidence. Further, we recommend contract language comply with KRS 45A.030(7) to ensure “[t]he Secretary of the Finance and Administration Cabinet shall not restrict the public release of any information which would otherwise be subject to public release if a state government agency was providing the services.” Finally, we recommend that the Department of Corrections work with the Finance and Administration Cabinet to revise the Master Agreement with Dismas Charities to include the standard contract language from KRS 45A.030(7).

Chapter 3

Findings and Recommendations

Finding 9: Certain contract requirements were not reviewed for compliance.

The Department of Corrections did not review certain contract requirements for compliance with the Master Agreement contract between the Department of Corrections and Dismas Charities. The Department of Corrections spent over \$7 million annually under a Master Agreement for halfway house services provided by Dismas Charities. See Table 12.

Table 12: Department of Corrections Master Agreement Expenditures

Fiscal Year	Halfway House Expenses (Master Agreement)
2008	\$ 7,498,840
2009	7,686,622
2010	7,606,358
Total	\$22,791,820

Source: E-MARS data

To assure the Department of Corrections that Dismas Charities complied with the requirements of the Master Agreement between Corrections and Dismas, Corrections conducted a minimum of two inspections per year at each of the seven Dismas Charities' halfway house facilities. As provided for in the contract, at least one of the inspections was announced beforehand to the facility, and at least one was unannounced. Additionally, the Contract Management Branch Manager and other Corrections' staff tried to visit the halfway houses every few months for oversight. Yet, the inspections conducted did not appear to be broad enough to ensure that all of the requirements specified in the contract were reviewed for compliance.

Inspections

During the inspections of the halfway house facilities, the Department of Corrections inspectors completed an Inspection Report form that included a detailed checklist of contract compliance requirements. The checklist used by the inspectors to review contract compliance covered the house's management, the design of the facility, safety emergency procedures, food service, and resident (inmate) rights. The inspectors relied on both their knowledge of contract compliance requirements and the Department of Corrections checklist to determine whether or not the facility was in compliance with the Master Agreement contract.

Once the inspection was completed, the inspector provided the respective director of the Dismas Charities halfway house facility with a copy of the inspection report, including details of any comments, concerns, and specific details of any non-compliance issues. If non-compliance issues were noted, the inspector listed the reason(s), quoted the specific statute (if applicable), and noted the corrections to be made to bring the facility back into compliance. The inspection report, including the findings, was then forwarded by the Department of Corrections' Contract Management Branch Manager to an Executive Staff member of Dismas Charities for a response.

The Executive Staff member was required to respond to the report within a certain timeframe, usually 30 days, and address any findings, including information as to how issues would be resolved. Subsequent inspections by the Department of Corrections staff confirmed corrective action was taken.

*Additional Contract
Compliance*

While the Department of Corrections inspection report checklist was quite detailed, it did not include all of the contract compliance requirements that were detailed in the contract. The following are additional contract requirements that were not included in the inspection checklist:

- A procedure for the dissemination of information about the center to the public, government agencies, and the media;
- A written report of all extraordinary or unusual occurrences within 48 hours of the occurrence;
- Certain information required for admission and release for each resident;
- Release of Information consent forms;
- Minimum compensation for employees;
- Minimum age of employees;
- Employee prohibitions;
- Ethics violations in employee personnel files;
- Compliance with all physical plant requirements;
- Written policies for security control, and safety and emergency procedures;
- Procedure for inspecting all facility areas accessible to residents for contraband and physical security at least weekly;
- Sanitation and hygiene requirements;
- Medical services provisions;
- Admission and release requirements;
- Inmate programs and services requirements;
- Inmate rights for law library, visitation, mail, telephone usage, religion, searches, disciplinary procedures, and Parole Board review;
- Work assignments; and,
- Safe Place terms and Conditions.

Per Corrections staff, the inspection report forms used were based on the Master Agreement requirements and were periodically updated based on any changes to the Agreement. Although there may have been some review of those areas that were not on the inspection report, there was no documentation that those items were reviewed. Furthermore, one of the inspectors asserted he only reviewed what was on the inspection report.

The inspection report used by the Department of Corrections serves as a good beginning for contract monitoring and compliance review, but is not inclusive of all significant areas of compliance. Accordingly, a more comprehensive, detailed inspection and/or review should be conducted in order to adequately monitor Dismas' compliance with the Master Agreement.

Findings and Recommendations

Direct Payments

In conjunction with a review of contract oversight and monitoring, a review of the procedures for payments made under the Master Agreement was conducted to determine whether the payments complied with the contract requirements. Direct payments from the Department of Corrections to Dismas Charities appear to comply with contract requirements and were adequately monitored by the Department of Corrections staff.

Recommendations

We recommend the Department of Corrections expand its monitoring and oversight of its Master Agreement with Dismas Charities for halfway house services to ensure that all significant contractual obligations relating to halfway houses are reviewed through its inspection process. The inspection form used in this process should include a checklist item for each area deemed subject to compliance oversight and should be periodically updated to include all significant areas of compliance.

Finding 10: A cost analysis was not performed by the Department of Corrections to determine the cost effectiveness of Dismas Charities.

The Department of Corrections did not complete an evaluation of the cost the Commonwealth would incur to operate halfway house facilities in lieu of using those operated by Dismas Charities or other similar vendors. Without a cost analysis, the Department of Corrections cannot clearly determine fair per diem rates that should be paid to vendors to house offenders at halfway house facilities. The Master Agreement contract between the Department of Corrections and Dismas Charities is a firm fixed unit price contract, established to “provide fully operational halfway house(s).” All state contracts are established under the authority of KRS Chapter 45A and a multitude of Kentucky Administrative Regulations and Finance and Administration Policies. The contract between the Department of Corrections and Dismas Charities provides housing and other rehabilitation services to the resident offenders sent to them by the Department of Corrections, based on the needs of the Department.

In 2008, the Department of Corrections increased its per diem rates paid for halfway house services by 2.8 percent. See Table 3. According to the Department of Corrections, the rate increase was approved, based on cost of living changes and other indices. However, a cost analysis was not completed. Until that increase, the per diem amounts had not changed since 2006.

Recommendations

We recommend the Department of Corrections conduct a periodic analysis, to compare the per diem rates paid to Dismas Charities for halfway house services to the costs that would have been incurred by the Commonwealth if the same services had been provided by the Department of Corrections internally. Such an analysis should project and identify any actual savings for the Commonwealth through the use of outside vendors such as Dismas Charities for halfway house services.

The Department of Corrections should use the results of this analysis also to determine whether its per diem rates need any adjustment in order to provide necessary and adequate community based supervision and treatment services to those within the prison system, as well as to determine that the Department is paying an appropriate amount for the services. Documentation of the analysis to support the per diem rates should be retained.

DISMAS CHARITIES, INC. RESPONSE



DISMAS CHARITIES, INC.

April 1, 2011

The Honorable Crit Luallen
Auditor of Public Accounts
209 St. Clair Street
Frankfort, KY 40601

RE: Dismas Charities, Inc. Board Governance Review

Dear Ms. Luallen:

On behalf of the Board of Directors, staff and our many volunteers who support the work of Dismas, we appreciate the governance recommendations provided by the Auditor of Public Accounts. Please accept this letter as our response.

We agree that as a company contracting with state and federal agencies, we have a responsibility to insure funds we earn are utilized in an effective and efficient manner. We meet this responsibility by exceeding the services required by our contracts in all of our centers. Nationally, Dismas earns funds through the awarding of open-bid, competitive contracts. In Kentucky, Dismas is paid the same flat rate and held to the same standards as all other non-profits, for-profits, and government entities.

Dismas is a non-profit government contractor. We are paid for services provided. We do not rely upon donations to operate. "Charities" in our name refers not to how we receive income, but to how we go about our mission. As a non-profit with charitable, religious roots, our culture, our motivation and our spirit toward our work is different than that of a for-profit company that must satisfy shareholders.

The marketing and compensation costs highlighted in the Report were considered and approved by the Board so that Dismas can effectively carry on its mission. We are proud to say that we have grown through the years because our people are always developing new and innovative ways to deliver our services but we have never lost sight of our mission to end the cycle of victimization.

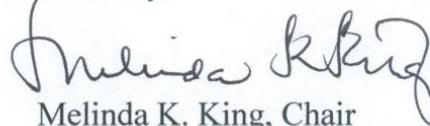
As a non-profit, our executives cannot be paid with the most highly valued compensation element in private industry: ownership in the company. For-profit companies simply can provide compensation packages that we cannot. Accordingly, we must rely on an attractive salary structure to hire and keep the skilled employees needed to manage a national, complex organization that employs more than 600 individuals and serves 5,600 residents a year across the country.

Finally, we disagreed on certain requests for documents because we believed they were outside the scope of the review. We utilized our corporate counsel to assist us in completing this complex review process and to maintain continuity throughout. With counsel's assistance, we provided more than 1,200 pages of documents that directly relate to our work in the Commonwealth and our governance, policies, procedures, and financial activities.

Though we believe that our organization has always been and continues to be well-managed, there is always room for improvement. And so, last September Dismas' Board began a re-examination of its existing governance policies and procedures. We enhanced these policies and procedures using your office's publication *Recommendations for Public and Non-Profit Boards* as a template. We also reviewed policies recommended by national non-profit organizations and then adopted revised board governance policies and procedures, which address the recommendations within the Report.

On behalf of Dismas, we appreciate the opportunity to submit this response and for your guidance regarding board governance.

Sincerely,

A handwritten signature in black ink, appearing to read "Melinda K. King". The signature is fluid and cursive, with the first name "Melinda" being more prominent than the last name "King".

Melinda K. King, Chair
Board of Directors
Dismas Charities, Inc.

DEPARTMENT OF CORRECTIONS RESPONSE



JUSTICE AND PUBLIC SAFETY CABINET

Steven L. Beshear
Governor

Department of Corrections

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J. Michael Brown
Secretary

LaDonna H. Thompson
Commissioner

April 1, 2011

The Honorable Crit Luallen
Auditor of Public Accounts
209 St. Clair Street
Frankfort, Kentucky 40601-1817

**RE: Agency Response to Examination of Certain Policies, Procedures, Controls,
and Financial Activity of Dismas Charities Inc.**

Dear Ms. Luallen:

On behalf of the Kentucky Department of Corrections (DOC), please accept this letter, and attached document, in response to the (Draft) Examination of Certain Policies, Procedures, Controls, and financial Activity of Dismas Charities, Inc. We appreciate the opportunity to provide this initial feedback to the findings and recommendations associated with the report, as well as the additional opinions expressed in it.

Please contact me if clarification is needed for any statements the Department of Corrections has submitted in this response.

Sincerely,

A handwritten signature in dark ink that reads "LaDonna H. Thompson".

LaDonna H. Thompson
Commissioner

Examination of Certain Policies, Procedures, Controls, and financial Activity of Dismas charities, Inc.

Department of Corrections of Recommendations:

8. We recommend that all contracts between the Department of Corrections and Dismas Charities, including no-bid contracts, provide language to allow the APA and other appropriate state agencies access to all pertinent contractor's records including, but not limited to, accounting records, documents, papers, records, or other evidence. Further, we recommend contract language comply with KRS 45A.030(7) to ensure "the Secretary of the Finance and Administration Cabinet shall now restrict the public release of any information which would otherwise be subject to public release if a state government agency was providing the services." Finally, we recommend that the Department of Corrections work with the Finance and Administration Cabinet to revise the Master Agreement with Dismas Charities to include the standard contract language from KRS 45A.030(7).

Response:

The Department of Corrections has initiated contract amendments to revise the Master Agreement with Dismas Charities, and all other halfway house contracts, to be inclusive of the standard contract language from KRS 45A.030(7). This process should be complete by April 30, 2011.

9. We recommend the Department of Corrections expand its monitoring and oversight of its Master Agreement with Dismas Charities for halfway house services to ensure that all significant contractual obligations relating to halfway houses are reviewed through its inspection process. The inspection form used in this process should include a checklist item for each area deemed subject to compliance oversight and should be periodically updated to include all significant areas of compliance.

Response:

The Department of Corrections is currently updating the inspection report checklist to include the contract compliance requirements as detailed in the contract and recommended in this report. The updated inspection report is being implemented for all halfway house inspections during April 2011.

The inspection report will be reviewed every two years, or when contracts are renegotiated, whichever comes first to ensure adequate monitoring of the contract terms per the Master Agreement.

10. We recommend the Department of Corrections conduct a periodic analysis, to compare the per diem rates paid to Dismas Charities for halfway house services to the cost that would have been incurred by the Commonwealth if the same services had been provided by the Department of Corrections internally. Such an analysis should project and identify any actual savings for the Commonwealth through the use of outside vendors such as Dismas Charities for halfway house services. The Department of Corrections should use the result of this analysis also to determine whether its per diem rates need any adjustment in order to provide necessary and adequate community based supervision and treatment services to those within the prison system, as well as to determine that the Department is paying an appropriate amount for those services. Documentation of the analysis to support the per diem rates should be retained.

Response:

The Department of Corrections will conduct periodic analysis to compare per diem rates for all halfway houses to the cost that would have been incurred by the Commonwealth if the same service had been provided by the Department of Corrections. The analysis will identify the savings. This analysis will be the basis to determine if the Department is paying the appropriate amount in order to provide necessary and adequate community based supervision and treatment services.